

**Regional Aspects of the Russian Economy Development Surveyed
by an Example of Development of a Social and Economic
Development Concept for the Republic of Altai**

**Moscow
2002**

Authors: S. Zhavoronkov, O. Izryadnova, V. Mau (scientific advisor), I. Starodubrovskaya (scientific advisor)

The present study and publication have been carried out within the framework of the CEPRA Project (a Russian-Canadian applied economic studies project) financed by the Canadian International Development Agency (CIDA).

Editor: N. Glavatskaya
Make-up: A. Astakhov

ISBN 5-93255-084-8
Publishers' License: ID No. 02079 of June 19, 2000
5 Gazetny Pereulok
Moscow 103918 Russia
Tel. (095) 229-6412, FAX (095) 203-8816
E-MAIL: root@iet.ru, WEB site: http://222.iet.ru

Contents

1

| | |
|--|-----------|
| INTRODUCTION | 4 |
| 1. MAIN TRENDS IN ECONOMIC DEVELOPMENT OF THE RUSSIAN FEDERATION REGIONS IN 1999 - 2001. | 6 |
| 1.1 General Description of Production Dynamics and Structure in the Russian Federation Regions..... | 6 |
| 1.1.1 Changes in the Revenue Structure and Production Profitability by Regions of the Russian Federation..... | 14 |
| 1.1.2 Dynamics of Investments in Fixed Assets..... | 18 |
| 1.1.3 Dynamics of Ultimate Consumption and Standard of Living | 27 |
| 2. ECONOMY OF THE REPUBLIC OF ALTAI IN 1998 - 2001..... | 32 |
| 2.1 Basic Social and Economic Characteristics of the Republic of Altai..... | 32 |
| 2.2 Real Sector of Economy. | 33 |
| 2.2.1 Economy Structure of the Republic of Altai | 33 |
| 2.2.2 Economic crisis in the republic in 1992-1997: trends and factors..... | 34 |
| 2.2.3 Specific features of economic recovery in 1998-2001 | 35 |
| 3. DETERMINATION OF PRIORITIES OF LONG-TERM SOCIAL AND ECONOMIC POLICY OF THE REPUBLIC OF ALTAI | 44 |
| 3.1 General Principles of Business Activity and Investment Attraction | 44 |
| 3.2. Main Directions of Economy Restructuring of Republic of Altai and Factors Contributing to Viability of Basic Sectors..... | 46 |
| 3.2.1 Tourism | 46 |
| 3.2.2. Development of Transportation Infrastructure | 49 |
| 3.2.3. Investment in Human Resources. Education and Culture. | 50 |
| 3.3 Economic Policy of the Republic of Altai and the Novgorod Oblast and Prospective Measures of Economic Policy Improvement..... | 53 |
| 3.4. Political Development Experience of the Republic of Altai and the Novgorod Oblast..... | 67 |
| CONCLUSION | 76 |

Introduction

To substantiate the long-term social and economic development strategy of Russia it is necessary to survey the regional aspect in full detail. Establishment of proportions between different territories that would be adequate to the market economy, equalization of regional differences in respect to social and ensuring economic development and effective functioning of the all-Russian market belong to the most important aspects of modernization and stable growth of the Russian economy. Implementation of a new strategy of territorial development of Russia requires not only pursuing a more active regional policy on the part of the federal center but also improving legal, institutional and economic relationship between the constituent entities of the federation.

The heterogeneity of the Russian social and economic space that has been formed historically influences the functioning of the state, structure and efficiency of the economy, strategy and tactics of institutional reforms and social and economic policy. As the crisis deepened and transition to the market economy was progressing, differentiation between regions intensified. As reforms were advancing and the market environment was forming it was revealed that regions with different structures of the economy and different mentality of the population and the authorities were able to adapt to the new conditions of management. The regulating role of the state relaxed significantly. This manifested itself in reduced state investments in fixed assets and abolition of regional social and economic compensation mechanisms. Consequently, in terms of average per capita real personal incomes, the difference between constituent entities of the Russian Federation became more than twentyfold. The sharp differentiation resulted in wider areas of depression and poverty, weaker mechanisms of interregional economic cooperation. All this impedes the implementation of a policy that would be consistent all over Russia. While the social and economic disparities between territories are in many respects caused by objective reasons, there is no denying that they should be smoothed. Society regards extreme interregional differences between the living standards of the federal center and the provinces as well as between various regions of the country as violation of social justice principles. It is of strategic importance for the state to implement a trenchant regional policy aimed at equalizing excessive differentiation in the levels of social and economic development.

An analysis of the moving forces and trends of the political and economic development of the constituent entities of the Russian Federation allows classifying the regions by the level of the social and economic development.

The group of underdeveloped regions includes the constituent entities of the Russian Federation whose economic potential for objective historical reasons has been traditionally several times lower than the average Russian figures. The economy of these regions has stagnated for a long time and it is characterized by low level of industrial diversification, underdeveloped infrastructure and a low level of social sphere development. The list of such regions has constantly included the Republic of Altai and Republic of Tuva, a number of republics in the North Caucasus, most of autonomous okrugs (with the exception of oil and gas producing entities). The state lends significant financial support to these regions, encouraging the process of self-development on the basis of utilizing competitive advantages, especially of natural and labor resources.

A continuous and deep economic recession and a sharp decline in living standards characterize the depressive regions of Russia. Such depressive regions include local zones in old industrial centers and agrarian and industrial regions in the Central European region, Ural, southern Siberia and Far East. Recession in these regions could be partially overcome with

expanding internal demand, including replacement of imports with internally produced products. The status of a number of depressive regions depends to a great extent on Russia's position in the world markets of weapons, aerospace technology, nuclear industry and other hi-tech sectors. For a number of depressive regions a change for economic growth is linked with resolving practical tasks of diversification, conversion and modernization in the field of production, creation of incentives for small business, improvement of investment climate and search for new markets. However, even under such growth scenarios some regions characterized by especially deep recession will continue receiving targeted governmental aid.

The group of problem regions also includes a considerable share of northern territories of Russia where the unfavorable climate and high cost of living, increased production and transportation costs and ecological fragility cannot be smoothed over by extremely rich natural resources.

The territorial development strategy should determine the priorities and stages of economic restructuring of the regions and a complex of measures and resources.

Experience shows that preconditions for a revival of the economy have developed in Russia. In the past three years the character of economic growth has been determined by a combined influence of a number of new factors that have emerged during the reform years. In conditions of transition to the market economy the urgent necessity of a qualitative change in the economic potential has become apparent. The mode of living and the related requirements to social sphere development have changed significantly. Transition to post-industrial and informational society has impacted Russia's role and place in the global economy as well as the role and place of certain constituent entities of the federation in the national economy. Russian integration in the global economy has caused toughening of environmental standards since the global community is moving to a stable growth paradigm.

One of strategic aims of territorial development is to harmonize the interests of all regions by attaining optimal specialization in the all-Russian and international division of labor and utilizing the resource potential and competitive advantages.

Specific directions of the country's territorial development strategy are linked with resolving large-scale regional problems that are crucial for the entire state. Modernizing regional economy and interregional infrastructure will create conditions for efficient participation of all constituent entities of the Russian Federation in the all-Russian market.

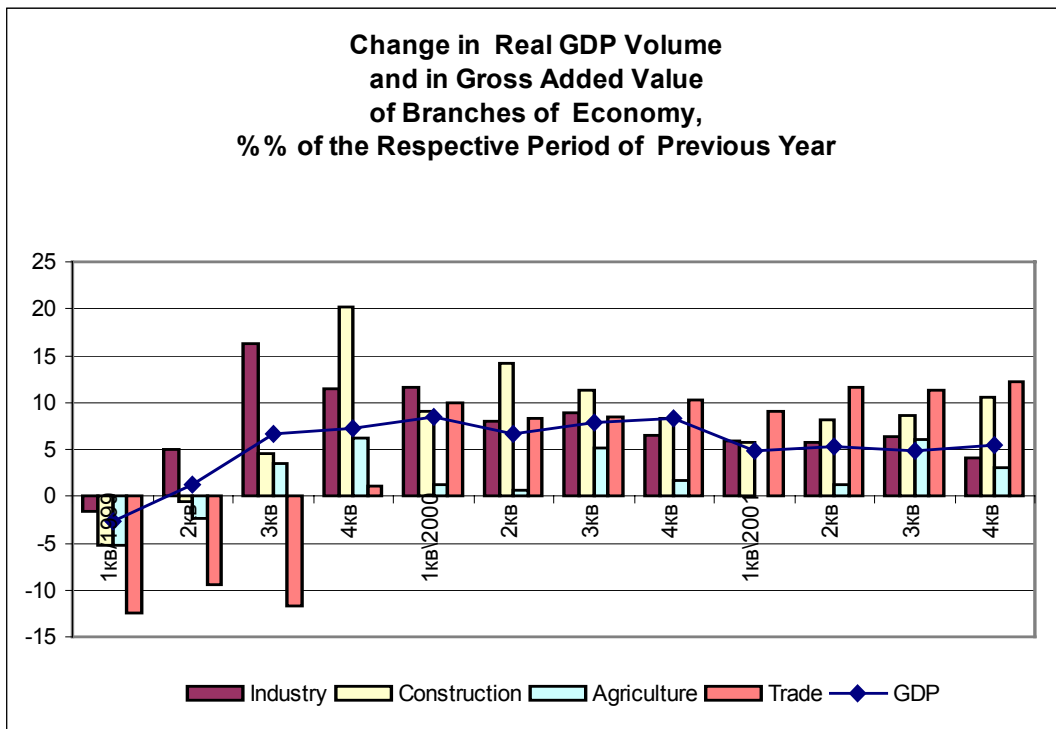
1. Main Trends in Economic Development of the Russian Federation Regions in 1999 - 2001.

1.1 General Description of Production Dynamics and Structure in the Russian Federation Regions.

Russian economy is undergoing deep structural changes related to creation of a fundamentally new economic model. Success in the advance of the reforms is undoubtedly linked to qualitative changes in technological and branch structures of production; such changes must, in their turn, cause adequate reorganization in the investment and labor potential of the Russian economy. The aim of the research was to analyze the changes, on that basis reveal general trends in the functioning of Russian economy in 1999 - 2001 and thereafter determine specific development properties for each region. The starting point for this research was an analysis of the dynamics of the general economic indicators for Russia and the regions.

Russian economy in 1999 - 2001 is characterized by high growth rates. The economic upsurge on the background of favorable external economic conditions and internal social and political stability. As at the end of 2001 the increment in GDP was 5 percent as opposed to the year 2000 level, investments grew by 8.2 percent and the gross industrial product by 4.9 percent. The growth in commodity production is supported by infrastructure of the service market that has developed during the reform years. In comparison to the year 2001 figures commercial load turnover of transportation has grown by 3.1 percent, wholesale turnover has increased by 5.2 percent and the amount of telecommunication services by 19.9 percent. While commodity production has grown by 6.5 percent during the year, market services have increased by 4.1 percent. Growth rate of services for consumer markets was greater as compared with the previous year. In 2001 retail trade turnover grew by 10.8 percent and the volume of chargeable human services increased by 0.8 percent. Thus, in 2001 the index of retail turnover growth exceeded the pre-crisis year 1997 level by 11.4 percent.

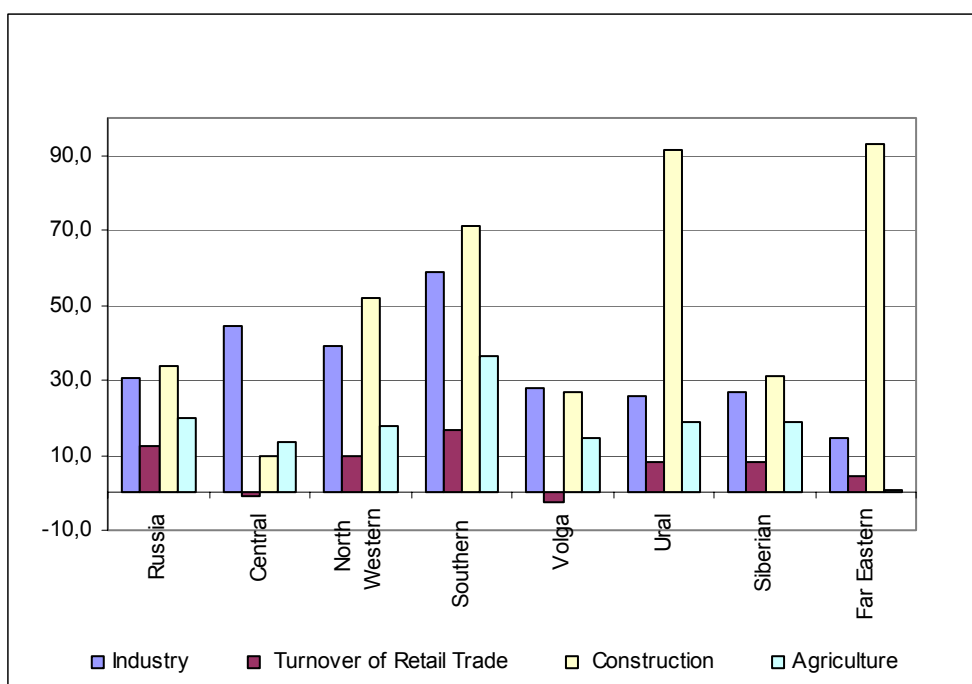
FIGURE 1



Economic growth was observed practically in all federal super-regions. Positive trends in the economies of most regions became stable. Since 1999 systematic growth in industrial output and investment demand has been observed. However, contributions of individual federal super-regions to the dynamics of general economic indicators vary and are determined by structural properties of each economy.

FIGURE 2

Changes in Dynamics of Physical Volume of Production Basic Sectors of Economy by Federal Super-regions in 2001, in % of 1998



Comparative analysis of the rates of economic growth shows that, while the growth rates of the Central, North-Western and Southern federal super-regions exceeded the average Russian level significantly, the Ural, Siberian and Far East federal super-regions lagged somewhat behind the European regions in the intensity with which the scale of commodity production was expanded. In 1999 - 2000, in a favorable external economic environment, the highest rates were observed in the federal super-regions characterized by a high degree of concentration of export-oriented production. As internal demand began to revive and investment activity grew, the regions oriented mainly at the internal market developed intensively. In 2000 - 2001 an increase in the contribution of machine building and construction industries to the dynamics of economic growth of federal super-regions and constituent entities of the Federation was observed. On the whole, as at the end of year 2001 the increment in industrial output lay in the range of 10 - 20 percent and only in 11 entities of the Federation a decline in production was observed.

Against the background of economic upsurge a pronounced asymmetry of production growth, personal incomes and ultimate demand has become especially apparent. Due to the asymmetry one cannot assess the economic situation unambiguously. While the results of economic activities in 2001 are undoubtedly successful, a comparison of the main indicators of social development demonstrates that the Russian economy has not yet managed to overcome the consequences of the October 1997 - August 1998 crisis.

In 1999 - 2000 the expansion of demand in households was checked by the low level of effective demand of the population; in 2001, however, the situation changed. An increase in real wages by 20.1 percent and the increase in real amount of assigned pensions by 21.4 percent positively influenced the revival of demand. Real income grew by 5.9 percent in 2001. However, despite the active social policy, the main indicators describing the living standards remain below the 1997 level. In 2001 the real incomes of population was approximately 83.0 percent of the 1997 level.

TABLE 1

Dynamics of the Main Macroeconomic Indicators in the Period from 1997 till 2001, Percent of the Previous Year

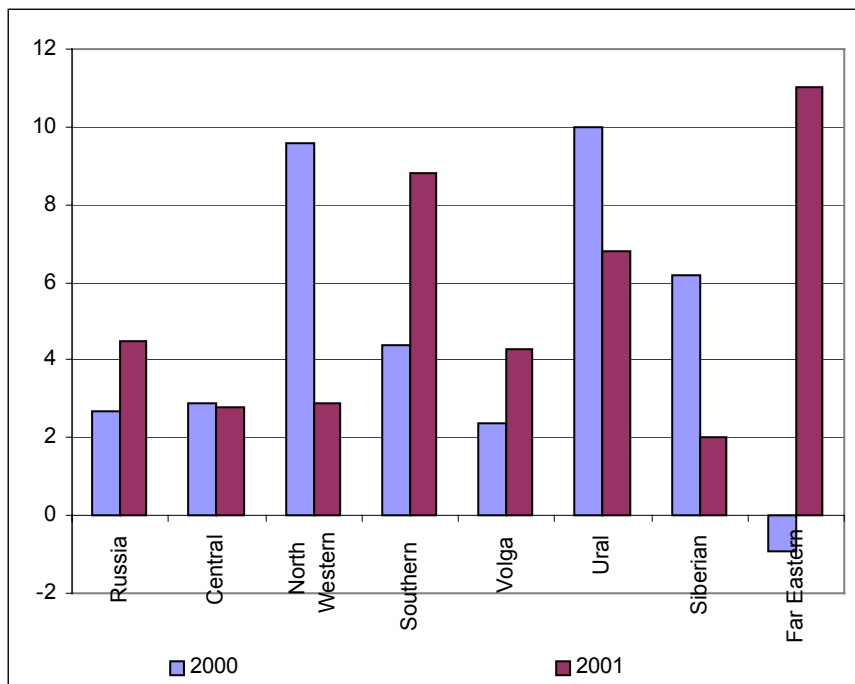
| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|-------|------|-------|-------|-------|
| Gross internal product | 100.9 | 95.1 | 103.5 | 107.7 | 105.0 |
| Production and services of basic industries | - | 94.2 | 104.6 | 108 | 105.7 |
| Industrial output | 102.0 | 95.1 | 108.1 | 109.0 | 104.9 |
| Investments in fixed assets | 95.0 | 93.3 | 105.3 | 117.7 | 108.7 |
| Agricultural output | 101.3 | 86.8 | 104.1 | 105.0 | 106.8 |
| Transportation turnover | 96.6 | 96.6 | 105.8 | 104.8 | 103.1 |
| Retail trade turnover | 104.7 | 96.7 | 92.3 | 108.9 | 110.8 |
| External trade turnover | 101.7 | 84.7 | 86.7 | 129.7 | 105.4 |
| Real disposable monetary incomes | 106.3 | 83.8 | 85.8 | 109.1 | 105.9 |

Source: State Committee for Statistics of the RF

It should be pointed out that, in spite of the general growth trend of the living standard of the population, this indicator differs significantly from territory to territory. In comparison to 1999 the growth in real monetary income was below the average Russian level in the Central and Volga federal super-regions. The rate of real income growth in the Siberian federal super-region was about the average Russian level. The indisputable leader in the growth rate of real income of the population during the past three years has been the Ural federal super-region that includes regions producing hydrocarbon raw materials. The dynamics of real income of the population correlates quite closely with the dynamics of industrial growth of some territories of the country. Besides, as comparative analysis reveals, the correlation of remuneration levels of hired labor force with the population employment structure by sectors of the economy impacts the living standards of the population since in most cases remuneration is the main source of income for the population.

FIGURE 3

Changes in Dynamics of Real Monetary Personal incomes by Federal Super-regions in 2000 - 2001, % of December of Previous Year



The period from 1998 till 2001 was distinguished for the change in the proportions of various sectors of the economy. The economic growth was accompanied with a revival of positive trends of production of goods and services. Positive GDP growth trends, observed since 1999, were supported by a production growth of basic industries of the economy. While in the first half of 1999 the industrial growth compensated for the previous year recession, a pronounced trend towards economic growth revealed itself in subsequent periods.

In analyzing the process of economic growth's revival one could divided the period under review into the following stages, depending on the intensity of various factors:

- active replacement of imports in the end of 1998 - first half of 1999 determined by further devaluation of the rouble and characterized by relatively low prices for the products of natural monopolies, a dramatic decline in imports and contained increment in wages;
- expansion of external demand starting from the second half of 1999 due to improved situation in the world market of fuel and energy and raw material resources;
- expansion of internal demand for investment resources since the 3rd quarter of 1999 due to a growth in revenues of enterprises;
- expansion of internal consumer demand starting with the second half of 2000 as a result of an active social policy.

Branches of the consumer complex that were traditionally oriented at the internal market were in the most advantageous position at the first stage. In 1999 the pickup in consumer goods output was 8.7 percent and exceeded the rate of general industrial growth and of retail trade turnover. The contribution of the consumer complex to the increment in industrial output in 1999 was 13.2 percent as opposed to 8.4 percent in 1998.

In 2000 - 2001 the influence of the consumer complex on the production growth in the economy remained at the previously attained level. The lag of output growth in the light and

food-processing industries testified to utilization of the residual potential of import replacement and the remaining effect of rouble devaluation. Confrontation of monthly dynamics of consumer goods output demonstrates gradual reduction in the rates of output growth of the light and food-processing industries as opposed to the dynamics of retail trade turnover. The light industry is especially sensitive to changes in the internal market. On the one hand, as effective demand grows, possibilities of expanding production are limited by technical and economic characteristics of the light industry's production facilities. On the other hand, if the exchange rate of the national and foreign currency changes, the industry loses competitive advantages and gives in to an onrush of imported products. While in the 1st quarter of 2001 the share of imports in the total amount of nonfoods was 45.9 percent, by the end of the year it grew to 51.4 percent.

Growth in investment activity is a distinctive feature of economic revival. As financial status of businesses improved and savings grew, from the second half of 1999 an increment in demand for capital goods was observed. This trend strengthened significantly in 2000 - 2001 under the influence of a growing investment demand of export-oriented industries for the products of the Russian machine-building industry. In 1999 - 2002 output in the investment complex grew by one third as compared to the 1998 level. Due to a well-developed system of interbranch cooperation production growth in machine building and construction material industries contributed to a growth in production in the connected branches. Growth in internal consumption of construction materials has positively influences the acceleration of the rate of production in the metallurgical and chemical and timber industries.

Consequences of the changes in the external economic situation were smoothed by the remaining trend of demand growth in the Russian market. Production growth was observed practically in all sectors as compared to 2000. Negative trends in the dynamics of industrial output manifested themselves in stagnation of production in the ferrous metallurgy and gas industry due to reduced exports and lower output of the pharmaceutical industry due to expanding imports. While production in machine building grew by 8.4 percent in comparison with year 2000, the production index in black metallurgy was 99.8 percent, in nonferrous metallurgy: 104.9 percent and in petrochemical industry 107.2 percent. The contribution of the machine-building industry to the increment in industrial output in 2001 was 35 percent; the contribution of the metallurgical complex was 20 percent.

Changes in the internal and external market determined the main structural shifts in production. One of the distinctive features of the industrial growth in 1999 - 2001 was the higher growth rate of the processing industry as opposed to the extractive industry. The production pickup in the processing industry was 38.2 percent in comparison to the 1998 level, while in the extractive industry it was 16.6 percent. The share of processing industries in the industrial output has been growing since 1999.

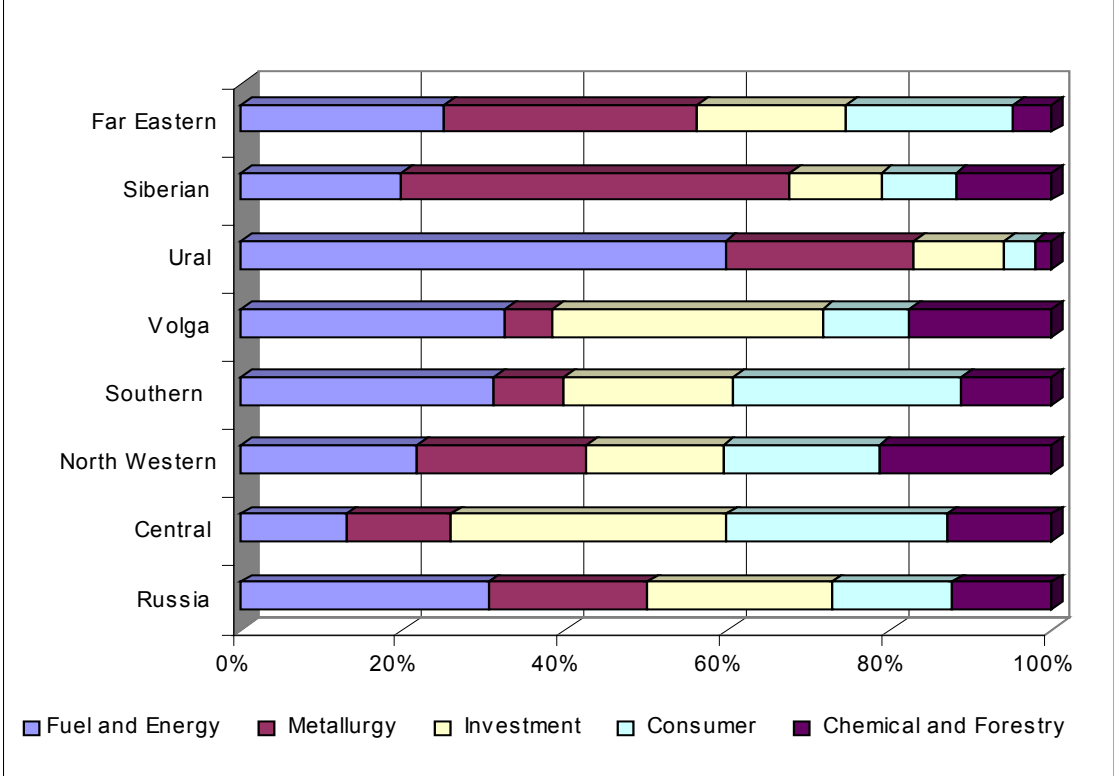
During the past two years the industries of the investment complex have been growing at a higher rate than other industries. The rise in investment activities that has been marked since 1999 has resulted in increased growth rates of machine building and production of construction material as well as of demand for construction services. The increase in investment demand has given additional impetus to the development of industries producing intermediary products.

Production dynamics by federal super-regions has turned out to be very sensitive to fluctuations of the internal market. While production dynamics of the Ural and Siberian federal super-regions have been affected by an vigorous growth in external demand for hydrocarbon raw materials and metals, the Central and Volga super-regions have seen a greater positive contribution of the investment complex industries. In the Southern federal

super-region, where the specific share of consumer industries has been traditionally high, the production growth has been encouraged by an expanded demand for Russian-made products.

FIGURE 4

Branch Structure of Industrial Production by Federal Super-regions in 2000, in %



An increase in the share of capital-forming branches in the structure of production has positively affected the investment environment in the national economy. A distinctive feature of machine building is a change in the structure of demand for machinery. In the 1992 - 1998 period the dynamics of machine building depended on the rate of car production, while in the past three years the situation has changed.

A rise in the production scale is observed practically in all branches of the machine building industry. The instrument making industry, telecommunication facilities industry and heavy machine building sectors manufacturing investment products for transportation, agriculture and oil producing industry have been developing quicker than other branches. Increased price competitiveness of the Russian machine building industry as opposed to imported analogs has caused an expansion of production for the branches of the consumer complex. Continuation of production facility optimization, company asset restructuring, certification and introduction of new models of machinery and equipment have allowed to increase such import-replacing

categories of machinery as electric train carriages, passenger carriages, precision instruments and electric engines.

The economic growth has influenced the military branches of the machine building complex, too.

However, in spite of the above mentioned positive trends in the machine building development, its contribution to the increment in industrial production is noticeably lower than that of the raw material complex. This is explained both by the nature of retrospective growth trends and by market situation of the past years.

The growth in consumer demand manifested itself in greater activity of the food-processing and light industry. Market saturation of the consumer market is stable and in full conformity with the effective demand of the population. The growth output was 5.0 percent in light industry and 8.4 percent in food-processing industry in 2001. However, even under these conditions the share of imports in the total retail turnover tends to grow. It is noteworthy that, while Russian producers have rather firm positions in the foodstuff turnover, in the non-food market the situation is characterized by intensive pressure of growing imports. For a short period of time, until the 3rd quarter of 1999, the growth rate of light industry products was higher than the dynamics of textile import and turnover of non-food products. As the competitive environment changes and import efficiency increases tendencies to replacement of Russian products intensify.

Output growth rates of the fuel and energy branches and export-oriented branches extracting raw materials were 104.9 and 103.6 percent, respectively. Slow down of the growth in raw material production reflects a trend towards lowering of the physical volume of export scale. In 2001 the share of exports in the total volume of realized industrial output was 23.3 percent as opposed to 32.2 percent in the previous period. This tendency develops against a background of intensive expansion of competitive import. This can have a negative impact on the economic development of the region. In 2000 imports grew by 19.5 percent while industrial output increased by 4.9 percent.

Factors bringing about a slowdown of industrial growth started to gain strength since the second half of 2000. Prices for energy resources were growing faster than prices for industrial production, the real exchange rate of the rouble was rising and wages were going up intensively; these processes caused changes in the competitive environment in the internal market. As a result, starting with the 4th quarter of 2000 profit growth rates began to slow down and investments in the branches of ultimate demand and of physical export volume began to diminish. Deeper limitations also revealed themselves alongside with the aforementioned market processes. Further output growth became impossible due to limitations imposed by technical and economic condition of the fixed assets of companies and by lack of equipment.

An analysis of production facility utilization demonstrates that a significant part of equipment cannot be used for production due to its wear and obsolescence. The load on production facilities differs quite considerably. In extractive branches characterized by a low share of added value the load is significantly higher than in processing branches. The degree of equipment load differs between plants even within one industry. Although active involvement of reserve production facilities resulted in a revival of economic activity, there is still a certain limit up to which equipment may be loaded.

A growth in demand in raw material industries could be generally covered by involving available facilities because the quality of raw material depends on the deposit and not on the extraction method. New technologies in extraction usually contribute to a cost reduction, higher productivity of labor, greater production of co-products etc. However, the correlation

between high degree of wear and facility utilization in the extractive industry shows that the load on equipment is critical.

In the processing industry, especially in hi-tech, production growth reserves are determined by the quality of equipment and technologies. Considerable wear and tear of fixed assets in processing industries is the reason of a very small load on equipment and a factor limiting further production growth possibilities.

The correlation between wear and tear degree and age structure of the fixed assets vividly demonstrates the dire necessity of intensifying renewal processes. In respect to the level of production facility utilization machine building lags behind most of other industry branches. The prolonged investment pause has resulted in stagnation of the structure of machine building. Consequently, in the conditions of a transition to the investment-based model of economic growth lack of equipment and machinery became a factor limiting production growth in the economy. What makes the situation even worse is the fact that, because of the failure to comply with the market criteria of quality, machine building cannot attain the necessary sales level that would provide the means for large-scale investments in the renovation of own production facilities.

Changes in the dynamics and structure of internal demand were accompanied with stronger competition between Russian producers as well as between Russian-made import-replacing products and imported products. The situation is complicated with the fact that as personal incomes grow and price-related competitive advantages of Russian-made products decrease conditions arise for a growth in imports both of consumer and investment products. This situation results in slower growth rates of processing industry; manufacturers become ever more dependent on investment dynamics and innovation strategy of development. The obsolete pool of equipment and production technologies and low level of labor productivity impose considerable limitations on expansion and structural changes in aggregate offer. Under such conditions, taking into account large market capacity and a gradual recovery of effective demand, foreign producers expand their presence in the Russian market. A reduction in investment activity of Russian producers may lead to losing the achieved positions and a change in the competitive environment.

1.1.1 Changes in the Revenue Structure and Production Profitability by Regions of the Russian Federation

The changes in dynamics and structure of GDP forming in respect to revenues from 1999 to 2001 took place under the influence of rouble devaluation and a growth in world prices for Russian-made exported products. In 2000 total profits of the economy were RUR 1,186.8 billion, which was 1.62 times more than the previous year level. In 2001 the situation changed. The financial result dynamics by federal super-regions were substantially influenced by specific features of branch structures and by the role and place of each territory in the Russian economy.

TABLE 2

Share of RF Federal Super-regions in the Main Social and Economic Indicators in 2000, %.

| | GDP | Investments in Fixed Assets | Industry | Net Profits | Export |
|---------------------------|------------|--|-----------------|--------------------|---------------|
| Russian Federation, total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| By Federal Super-regions | | | | | |

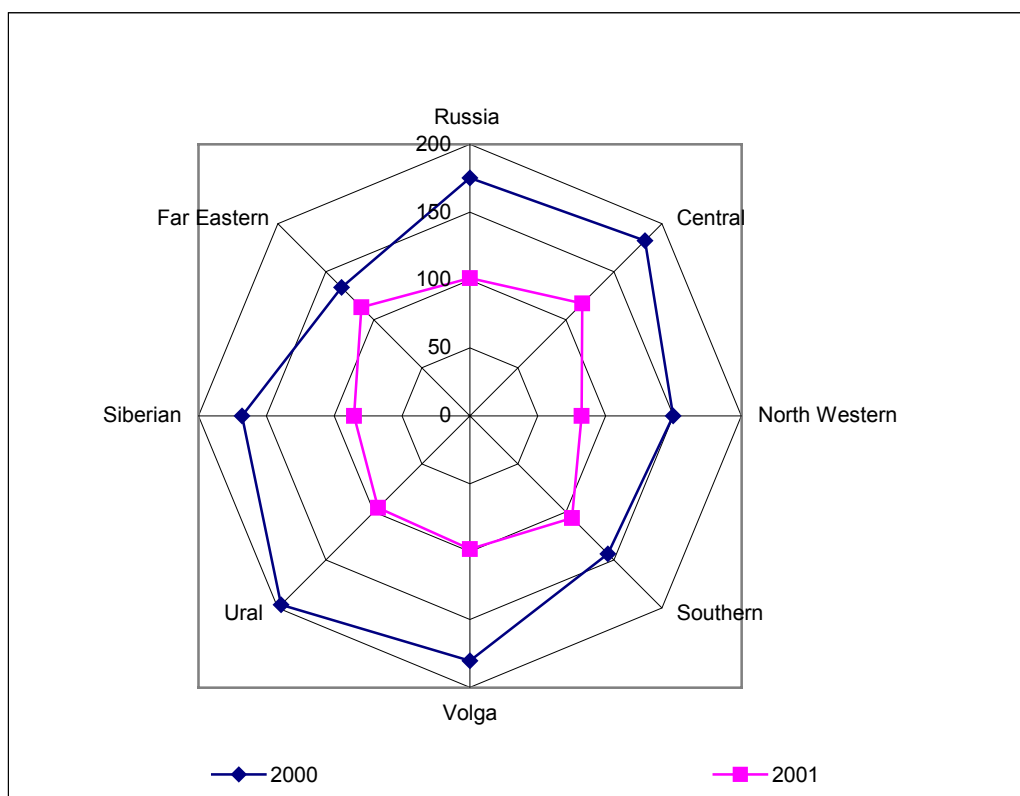
| | | | | | |
|---------------|------|------|------|------|------|
| Central | 29.2 | 29.1 | 21.3 | 25.6 | 35.4 |
| North-Western | 10.3 | 11.6 | 12.6 | 10.7 | 10.6 |
| Southern | 7.9 | 9.6 | 6.0 | 4.8 | 3.6 |
| Volga | 19.3 | 17.2 | 23.7 | 18.7 | 13.7 |
| Ural | 14.2 | 17.2 | 16.9 | 25.3 | 20.9 |
| Siberian | 13.1 | 9.2 | 13.6 | 11.8 | 12.4 |
| Far Eastern | 6.0 | 6.1 | 5.9 | 3.1 | 3.4 |

Source: State Committee for Statistics of the RF

Starting with early 2001, profit dynamics demonstrate continuous deceleration of growth rates in all branches of the economy and all regions. And, while in 2000 the intensive growth in export revenues affected profit dynamics in the Ural federal super-region significantly as opposed to other regions, in 2001 the Central federal super-region increased its contribution to the formation of financial indicators.

FIGURE 5

Dynamics of Netted Profits by Federal Super-regions in 2000 and 2001, in % of previous year



In 2001 the net financial result was RUR 1,144.7 billion, with RUR 602.2 billion out of them recorded by industry. The rate of profit in industry reduced from 18.0 percent in 2000 to 14.7 percent in 2001. The reduction of the profit rate in industry was brought about by growing production costs caused by an increase in wholesale prices and tariffs for utilized material resources while prices of industrial producers were growing more slowly, and by the rates of growth in personnel wages that were quicker in comparison to price dynamics for ultimate

products. Besides, a relative deterioration of external economic market for a number of Russian exports positions. In case this tendency keeps developing, it would be ill-advised to count on preservation of the investment upsurge, which is, in fact, the main source of growth. At the same time, it is necessary to point out that, at the end of the year there was observed an increment in the share of profits in the investment resources that is invested in production development. This reflects a change in business priorities and motivation. Russian businessmen link the prospects of keeping and expanding positions in the internal and external markets with intensification of reequipment and renovation of production. In the total number of companies that take an active stance with respect to innovation, almost 20 percent plan to reduce material costs, power consumption of equipment and replacement of obsolete product lines, and approximately one third of the companies intend to improve quality and ensure compliance with modern standards. While in 2000 the rise in investment demand was based on an increase in revenues of export-oriented industry branches, in 2001 it is the investment and consumer complex and service sector that drive the investment revival. While profits in the fuel complex are lower by 19.6 percent that in 2000, in nonferrous industry lower by 27.0 percent in comparison to 2000 and in ferrous industry almost half of the previous year level, in machine building profits rose by 32.0 percent, in construction materials by 37.2 percent and in construction by 27.5 percent. The present investment demand is characterized by a structural shift towards a greater share of products of machine building industry, which supports production of equipment; at the same time, demand for construction services and works has been growing. Trends towards inflation reduction are clearly a positive factor that supports the level of business activities.

The growth in production and revenues has been accompanied with an improvement of the structure of settlements between companies and an increase in tax payments to the budgetary system. The percentage of net taxes on production and import in the GDP has grown by 2 percentage points as compared to 1998.

TABLE 3

Structure of Gross Domestic Product, by Revenue Source, % of the Total

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|--|-------|-------|-------|-------|-------|-------|-------|
| Total GDP, including: | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Remuneration of hired workforce, including hidden payments | 45.2 | 49.6 | 50 | 47.2 | 40.6 | 40.2 | 44.9 |
| Net taxes on production and imports | 11.9 | 13.5 | 14.5 | 15.1 | 16.1 | 17.1 | 16.6 |
| Gross profits of the economy and gross mixed revenues | 42.9 | 36.9 | 35.5 | 37.7 | 43.3 | 42.7 | 38.5 |

Source: State Committee for Statistics of the RF, Ministry of Economic Development of the RF

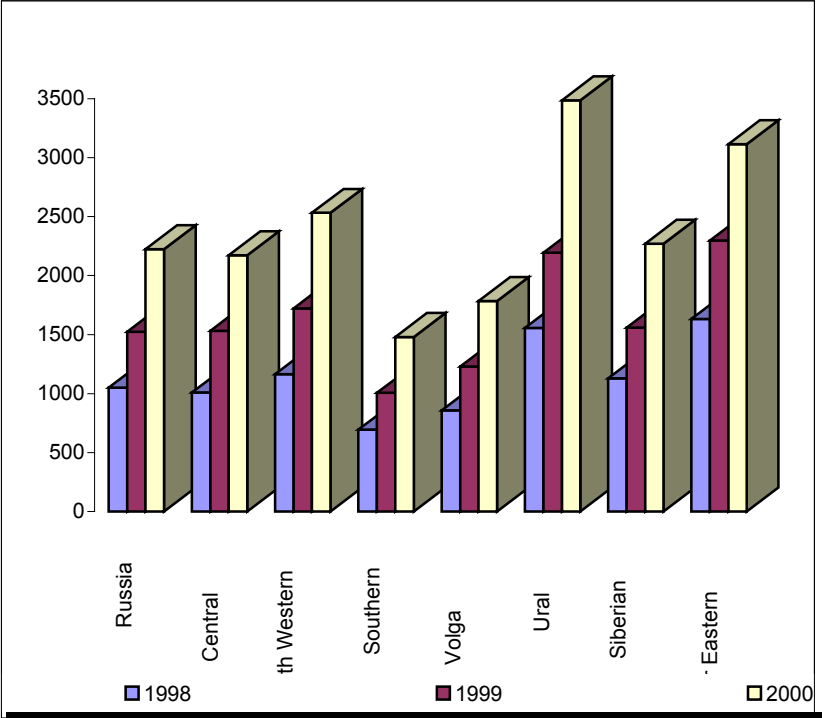
While construction branch and branches related to market infrastructure were developing at a high rate, the share of industry in the total profit of economy reduced to 54.6 percent as opposed to 60.4 percent in 2000. The essence of structural shifts in the forming of gross profits of industry in the period from 1999 to 2000 is that the processing industries gave the place of the main source of profits to the fuel and energy complex and industries relating to raw materials. According to calculations, the share of extractive industries and preliminary processing of raw materials in the total amount of industry profits grew by almost 35.0 percentage points.

It should be pointed out that in 2000 - 2001 companies engaged in oil production, oil processing, ferrous and nonferrous metallurgy accounted for the greatest growth in jobs. Increase in production occurred against a background of wage differentiation between the

extractive and processing sectors of the industry. This results in lower factorial remuneration of labor in the processing sector and service sector. Taking into account that almost 90 percent of the economically active population are engaged in the processing industry and service sector and that wages of hired personnel form over 80 percent of monetary personal incomes, it should be noted that low effective demand on the part of these population categories is a significant factor limiting the rate of economic growth.

In conditions of a developing economy and in the wake of rouble devaluation the profits of the main sectors of the economy almost tripled in 1999 while the nominal allocated wage increased 1.4 times. In 2000 the rate of profit growth was 1.2 times higher than wage growth. In 2001, in the conditions of active social policy, the wages grew 1.3 times quicker than profits. As a result, in 1999 the share of gross profits in the GDP grew to 43.1 percent as opposed to 37.7 percent in 1998, while the share of remuneration of hired workforce reduced to 40.9 percent from 47.2 percent, respectively. Due to the policy of restraining the growth in personal incomes and consumer price dynamics as compared with producer prices in industry and construction, the share of remuneration of hired labor in the GDP remained in 2000 approximately at the level of the previous year. In 2001 a marked trend towards growth in remuneration of labor was observed in the GDP structure.

FIGURE 6
Allocated Wages by Regions of Russia, RUR



The social-psychological climate in years 2000 - 2001 was positively influenced by a change in the labor market and the newly appeared confidence of the population in the possibility to find a job. The number of unemployed citizens calculated according to the International Labor Organization methodology reduced over the course of 2001 by almost 0.6 million people to reach 6.4 million in the end of the year. Revival of production led to growth in demand for workforce. The number of vacancies reported to employment agencies was 887.0 thousand as

at the end of 2001 as opposed to 751.0 thousand in December of 2000. The load of unemployed population on one vacancy reduced.

TABLE 4

Labor Market in Federal Super-regions, at Year End, Thousand People

| | Number of Unemployed Citizens | | | Need for Personnel Reported to Employment Agencies | | |
|--------------------------|-------------------------------|--------|--------|--|-------|-------|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Russian Federation | 1442,7 | 1196,5 | 1311,0 | 586,5 | 750,9 | 887,3 |
| By Federal Super-regions | | | | | | |
| Central | 325,2 | 260,4 | 271,3 | 226,1 | 283,4 | 328,5 |
| North-Western | 190,6 | 141 | 169,7 | 78,8 | 94,4 | 131,2 |
| Southern | 154,2 | 144 | 159,3 | 68,5 | 76,8 | 85,0 |
| Volga | 310,1 | 247,3 | 251,6 | 96,2 | 126,2 | 153,7 |
| Ural | 112,5 | 96,7 | 108 | 51,5 | 76,8 | 76,2 |
| Siberian | 222,7 | 202 | 249,4 | 44,8 | 64,2 | 80,7 |
| Far Eastern | 113,5 | 95,1 | 101,7 | 211 | 25,4 | 32,0 |

Source:: State Committee for Statistics of the RF

1.1.2 Dynamics of Investments in Fixed Assets

Intensive growth in investment demand has become one of the distinctive features of Russian economy development in the past two years. During this period the growth rate of investments in fixed assets has continuously surpassed GDP dynamics and the output of basic industries. The percentage of investments in fixed assets in the total GDP has grown up to 17.7 percent as opposed to 16.8 percent in 2000. This tendency has been favorably influenced by an expansion of internal demand due to increase in investing own and borrowed funds and by reduction in growth rate of manufacturer prices in industry and construction.

The amount of investments in fixed assets from all sources of financing was RUR 1,599.5 billion in 2001. This is 8.7 percent higher than the level of the previous year. Intensification of investment activities in 2001 was accompanied with a growth in demand for construction services and capital goods. The volume of work carried out by construction organizations increased by 9.9 percent in comparison with 2000, the growth in gross machine building production increased by 7.2 percent; the growth in construction material production increased by 5.5 percent. A growth in investments in fixed assets has been observed in all federal super-regions with the exception of the Central and Southern regions.

The economic rise of 1999 - 2001 has been based chiefly on growing investment activities in the northern and Asian parts of the Russian Federation.

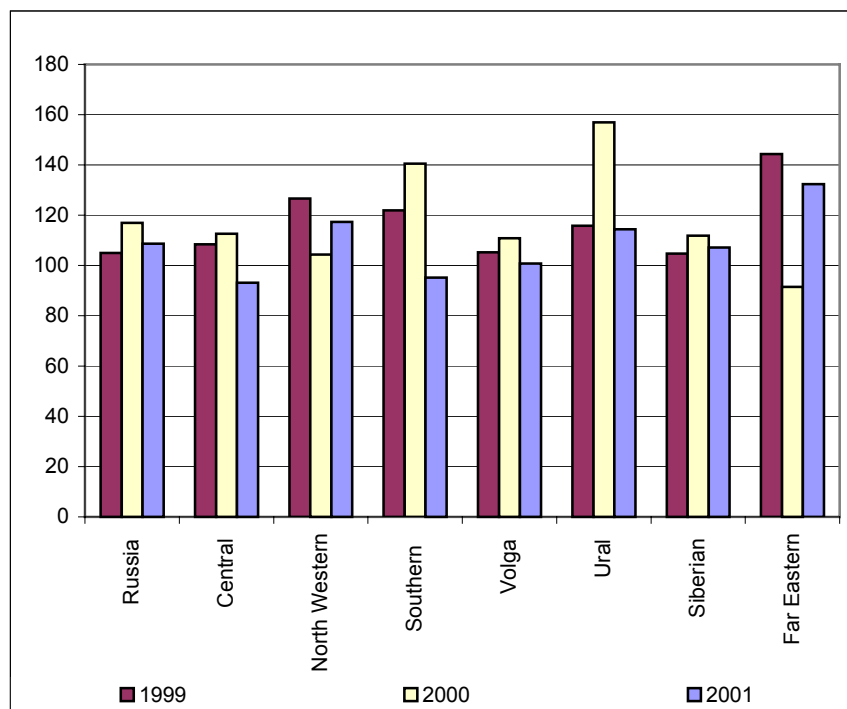
A high level of investment activities is typical of super-regions and regions whose economy is based either on extraction and preliminary processing of raw materials or on industries that are important for life support of the state. The social and economic situation in this group of regions is characterized by a high degree of per capita GDP and amount of investments in fixed assets, fiscal capacity, development of international relations, intensive growth in commodity turnover, increased revenues and purchasing capacity of the population and, consequently, by a lower share of poor population in comparison with the average Russian figure.

While investments in 2001 grew by 33.5 percent as opposed to 1998, investments in the Far East federal super-region increased 1.7 times and doubled in the Ural federal super-region that includes territories in Western Siberia rich in oil and gas. The intensive investment growth in the Ural federal region (that accounts for more than 20 percent of investments in fixed assets in the Russian economy on the whole) has determined the nature of the shift in proportions between the federal regions.

The nature and dynamics of investment activities in the Southern federal regions is in many respects explained by reorientation of financial flows which is related to the recovery of economies of the republics of Northern Caucasia, in particular Chechnya and Dagestan.

FIGURE 7

Dynamics of Investments in Fixed Assets by Federal Super-regions for the 1999 - 2001 period, in % of previous year



The investment upsurge in the 1999 - 2001 period had a structural nature and was determined by an aggregate influence of changes in industry and technology as well as reproductive processes in the national economy. The main factors directly impacting investment activities in the region are the financial status and capital intensity of the plants operating there, level of infrastructure development and the economic and geographical location. On the other hand, it is necessary to point out that there is only limited sense in analyzing the branch aspect of investment appeal at the federal level due to a high degree of regional differentiation of economic conditions. E.g., many regions have demonstrated a sharp growth in investment appeal due to substantial amounts of investments in branches that have little prospects on the federal scale but are indispensable for the region.

It is obvious that the regions with a high degree of concentration of natural monopolies and highly monopolized export-oriented industries with a secure demand both in the internal and

external markets have taken top positions. The regions whose economy is oriented mainly at the internal market are significantly less attractive for investors and are characterized by more moderate growth rates.

Redistribution of investment flows has been accompanied by a growth in the share of industry branches related to the infrastructure. In the period from 1999 to 2001 transportation, telecommunications and trade accounted on average for 25 percent of the total volume of investments in fixed assets as opposed to 15 percent on average in the 1992 - 1996 period. A rise in investment activity in the industry branches of the infrastructure and an expansion of demand for the services of these industry branches is an indicator of economic growth potential, especially because the investment policy in this sector was oriented primarily at resolving the issues of future development. The 1999 - 2001 period is characterized by a trend towards expansion of the market and the service structure in the conditions of contained tariffs. This allowed businessmen not only to expand their segments in the service market but also to develop a certain potential for further growth. And indeed, the most important factor in the conditions of economic growth was the fact that the market turned out to utilize in full the infrastructure established over the course of the reforms.

The dynamics of investments in industry in the conditions of economic growth developed under the influence of substantial shifts in the industry branch structure.

In late 1998 there appeared clear signs of an investment revival. Starting with the 4th quarter of 1998 growth rates of investments in industry leave the dynamics of production in the industry far behind and are the main incentive of economic growth. In 1999 - 2001 the average yearly increase in investments in fixed assets in industry was 12.2 percent while industrial output grew by 7.3 percent. The growth in investments in fixed assets had a predominant effect on the production dynamics and was accompanied by intensive growth in output in all branches of the investment complex. The output growth in machine building in 2001 was 50.5 percent as opposed to 1998; in production of construction materials it was 40.0 percent and in the area of construction services and works it was 27.3 percent.

Continued investment activity caused an increase in construction material production. A revival of this branch is accompanied with a shift in activities towards branches and plants oriented at using new technologies in construction and in particular at developing products that would replace imports. It is in these branches that production restructuring in the past years ran in parallel with active modernization on the basis of Russian and foreign state-of-the-art technologies and with establishment of companies with foreign participation. As economic situation changes and demand for expensive foreign products falls sharply, Russian producers successfully take up their market niches by offering in the internal market construction materials competitive in prices and quality. Besides, the dynamics and structure of construction material production is affected both by changes in proportion between industrial and social and civil construction, on the one hand, and by introduction of new methods of construction and mounting operations.

In assessing the status and development prospects of the Russian economy it is necessary to take into account that an upsurge in investment activity is to a considerable extent explained by the market situation. While priorities were experiencing fundamental changes, the investment structure was transformed due to a growing demand in the fuel and energy complex and metallurgical complex whose total share in the investments in industry exceeded 70 percent in 2001.

In fact, the investment demand in the 2000 - 2001 period was initiated exclusively by the oil production industry, which accounted for more than 30 percent of investments in industry. Although exporters increased investment expenditure on the development of the core business, it is with great caution that they invest surplus funds in the Russian economy.

Hence, the gap between energy resource producers (exporters) and the majority of the remaining economy widens.

The breakdown of investment structure by branches looks as follows: the complex of fuel branches accounts for 53.3 percent, out of which 34.8 percent account for oil extraction. 4023 new oil wells were put into operation in 2001; this is 18.6 percent more than in prior year. Besides, as a result of putting into operation in 2001 the wells that had been previously standing still additional 5.7 million tons of oil were produced; this is 23.5 percent of the total growth in oil production in the Russian Federation. The share of investments in the oil processing industry grew by 2.2 percentage points in comparison with year 2000. However, the proportions of investment distribution between the producing and processing branches of the oil complex are shifting toward a greater share of oil production. The more contained dynamics of investments in oil processing in the current year has resulted in fixing the share of fine processing at the 2000 level.

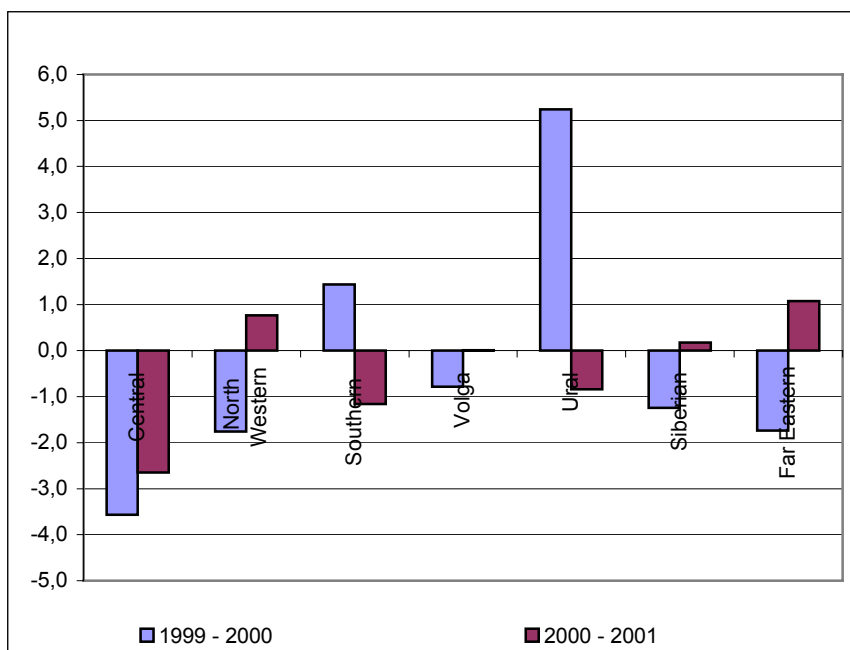
The growth in investment demand on the part of oil companies caused an acceleration of production rates of the equipment for extraction of hydrocarbons. Despite the intensive growth in the rate of production of equipment for the oil industry, an insufficient production volume and unpractical production structure prevent from overcoming the protracted lag in the rates of production drilling. On the other hand, factors limiting the raising of the rates of production include the insufficient scale of investments in oil production and related branches.

As oil production developed intensively, the growing share of the Ural federal super-region, which is the main area of hydrocarbon production, influenced the territorial structure of investment demand. The specific share of the Ural federal super-region grew by 4.4 percentage points in the investment structure in comparison with 1999 and the region accounted for more than 20 percent of investments in the Russian economy. The Central federal super-region yielded its leadership to the Asian and southern parts of Russia.

The proportion between industry and agriculture is of fundamental importance for the assessment of the regional aspect of investment dynamics. The agricultural, low- and moderately urbanized regions – Northern Caucasia, Central Black Soil Region, and southern regions of the Urals and Western Siberia – have greater inner potential of providing themselves with food and maintaining the living standards. The industrial, highly urbanized regions of the European center and the Urals, all other conditions being equal, turn out to be more vulnerable. However, in the conditions of economic growth precisely these regions become the leaders of the national economy.

FIGURE 8

Changes in Structure of Investments in Fixed Assets by Federal Super-regions in 1999 - 2001, in % for the Respective Period



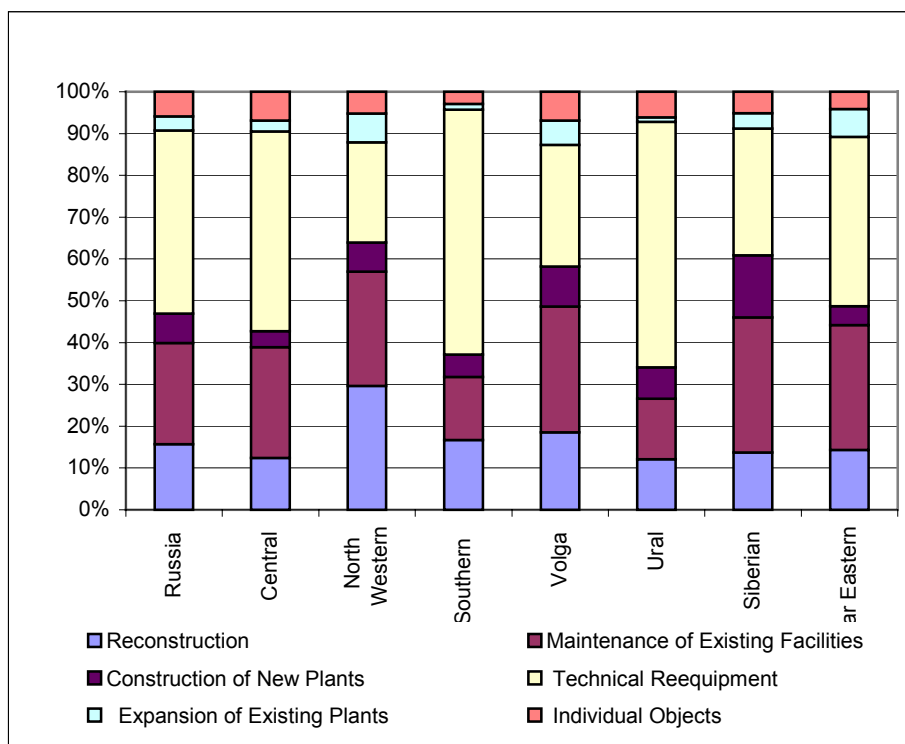
The dynamics and structure of investment distribution over the regions reflects the Russian business's energetic response to the changes in the internal market. As the investment demand grows, machine building industry demonstrates higher growth rates as opposed to the industrial production output. This shows that Russian producers react flexibly and quickly at the changes in the internal market.

As a result of economic growth it becomes important to renew the active part of fixed assets, attain qualitative improvement of production technology and increase its efficiency. In the conditions of limited investment resources companies were chiefly seeking to involve in production competitive reserve facilities and to modernize production by purchasing new production lines. Expenses on purchase of production lines and complexes take up ca. 10 to 15 percent in the structure of investments on equipment, while the remaining part accounts for acquisition of individual plants. In this connection it is necessary to point out that such an investment structure that is caused by financial limitations results in sticking to obsolete technologies and cannot contribute to production of competitive hi-tech equipment.

The reproductive structure of investments depends on the status of fixed assets. In the conditions of economic growth in 1999 - 2001 and increase in investment demand the highest share of investment utilization has been observed in the Ural federal super-region. This has happened because oil companies have increased the scale of exploration drilling by 15.6 percent as opposed to 2000 and put into operation 4.0 thousand new wells.

FIGURE 9

Reproductive Structure of Investments in Fixed Assets by Federal Super-regions in 2000, in % of total.



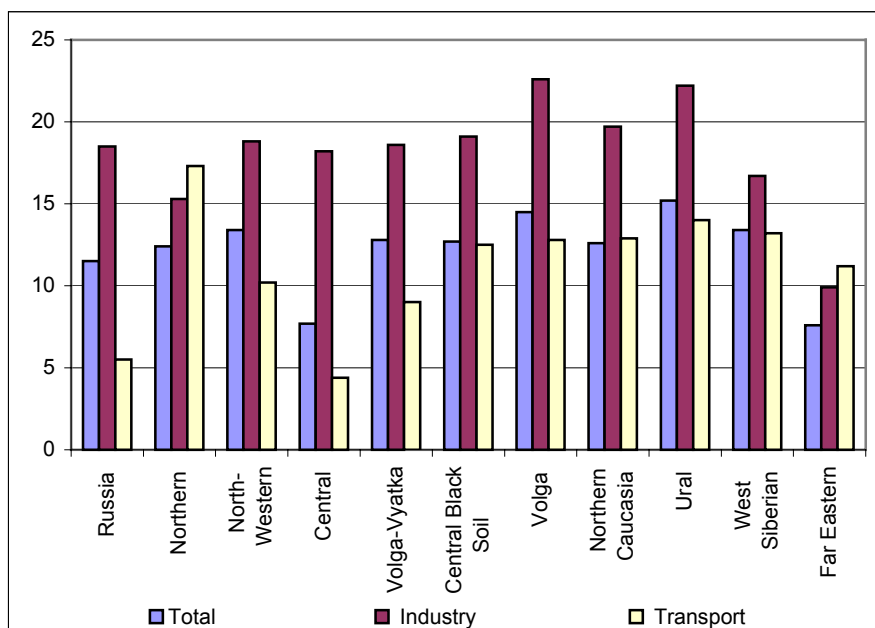
An analysis of production facility utilization shows that a considerable part of equipment cannot be used for production due to its wear and obsolescence. The loads on production facilities differ quite significantly. In extractive branches that are characterized by a low share of added value the load on equipment is much higher than in processing branches. The degree of equipment load differs between plants even within one industry. Although active involvement of reserve production facilities resulted in a revival of economic activity, there is still a certain limit up to which equipment may be loaded. A comparative analysis of the dynamics and status of fixed assets demonstrates that in the Ural, Volga and Siberian federal super-regions the wear and tear of production facilities is at the critical level.

A pickup in demand in raw material industries could be generally covered by involving available facilities because the quality of raw material depends on the deposit and not on the extraction method. New technologies in extraction usually contribute to a cost reduction, higher productivity of labor, greater production of co-products etc. However, the correlation between high degree of wear and tear and facility utilization in the extractive industry shows that the load on equipment is critical.

In the processing industry, especially in hi-tech, production growth reserves are determined by the quality of equipment and technologies. Considerable wear and tear of fixed assets in processing industries is the reason of a low degree of production facility utilization and a factor limiting further production growth possibilities.

FIGURE 10

Weight of Worn Out Fixed Assets in the Total Amount by Economy Branches of Economic Regions



Actual growth rates of the real sector of economy are significantly higher than the plan figures underlying the 2001 budget. The higher growth rate of internal demand as compared to the external demand is a distinctive feature of the development of economy in the current year. The share of internal demand in the GDP structure in 2001 grew up to 86.7 percent as against 79.6 percent in the previous year.

The greater activity of Russian business allowed to expect that, other conditions being equal, the GDP growth in 2001 would be about 103 - 104 percent. However, despite the relatively less favorable situation in the world market of raw materials and fuel and energy resources in comparison with 2000, a dynamic development of national economy gave additional impetus to the growth of the national economy. A comparative analysis of changes in GDP dynamics and structure over the course of the reforms shows that, while in 1992 - 1996 a growth in external demand compensated for a contraction of the internal market, in subsequent years the situation changes.

The economic upgrowth of the Russian economy in 1999 - 2001 is characterized by a simultaneous increase of both the internal and external demands. As the open market economy is taking shape, cumulative influence of external factors becomes stronger. On the one hand, contraction of imports to almost one half of the pre-crisis level has provided with space for intensive development of national production and growth in revenues of producers of goods and services. On the other hand, a growth in export revenues in the economy has considerably influenced the change in the structure and dynamics of ultimate demand.

In analyzing the stability of the Russian economy it is necessary to point out that the correlation between external factors affecting production growth in 2000 and in 2001 was different. While in 2000 the most important factor of production growth was the increase in world prices for energy resources and nonferrous metals, in 2001 the influence of external factors started to abate gradually. Starting with 2000 the physical volume of imports grows again faster than the dynamics of exports and GDP; lower growth rates of the physical volume of exports in late 2000 is explained by the situation in world markets of raw materials, and an intensive growth in imports throughout 2001 is connected only with internal problems.

A growth in internal demand in 2000 - 2001 brought about by export-oriented branches of the Russian industry was based on inertial growth of a relatively narrow segment of the national economy.

One of the reasons for low competitiveness of Russian-made products is the fact that economic growth was mainly oriented at increasing the degree of utilization of production facilities and involving reserve facilities. Substantial changes in commissioning of new production facilities prevented from implementing a consistent policy of import replacement and diversifying export flows. Since early 2000, trends towards a higher share of imports started to gain strength in the structure of product resources of the consumer market and the market of material and technical products. Furthermore, the increment in imports in 2001 was promoted by real strengthening of the rouble. As a result, according to the Ministry of Economic Development of the RF, net exports in 2001 were 89.1 percent of the prior year level. It is a very alarming signal for the Russian economy because a reduction in net exports usually leads to lower rates of economic growth.

Taking into account low investment activity in the previous accounting periods, the scale of investments in fixed assets did not conform to the real need for renewal and modernization of the equipment stock that affects economic efficiency negatively. The task of an investment maneuver towards the branches producing goods and services with a higher share of added value that would ensure competitiveness of the Russian economy has remained unresolved.

An increasing scale of savings in the economy has intensified the problem of transformation of gross savings into investments. The rate of reforms in the financial sector of the economy remains extremely low and the share of banking capital in lending to the real sector of the economy continues to be reduced. Own capital of enterprises remains the main source of investments since the mechanism of interbranch capital redistribution and accumulation of gross savings for purposes of developing the competitive components of the economy does not function.

The remaining low level of personal incomes negatively influences the investment dynamics. The existing level of internal effective demand in the consumer market limited the possibilities of increasing the production of goods and services. On top of that, since late 2000 lower profit growth rates, intensification of inflationary processes and a considerable increase in prices and tariffs for the products and services of natural monopolies began to affect the investment activity dynamics.

In spite of the favorable combination of world prices and holding effect of devaluation, the investment climate in 2000 remained unchanged. Lack of structural reforms prevented normalization of the financial sphere and real sector. Instability of the legal environment also contributed to the pertaining high degree of risk and unfavorable business and investment climate. Lack of normative and legal acts that ensure protection of rights of ownership, improvement of corporate governance, equalization of conditions of competition, optimization of administrative market regulation and greater transparency of business operations is a factor, which restrains investment activities both of the Russian and foreign capital.

In the circumstances investment activities in 2000 and 2001 were determined by opposite tendencies. On the one hand, a high rate of investment growth and expansion of internal sources of financing is observed, and, on the other hand, calculations show that the level of capital flight from Russia in 2001 remained at practically the same level.

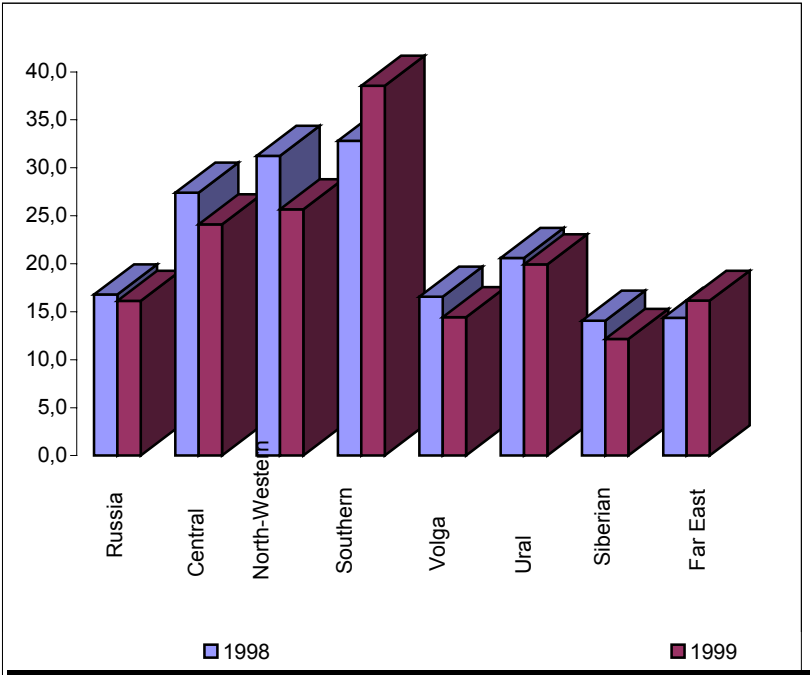
Under the conditions of economic growth it became obvious that investment management was not coordinated with dynamic restructuring processes in the Russian economy. Therefore it is necessary to eliminate these negative factors in the investment model of economic

development of the Russian economy formed within the framework of a long-term strategy of the government for the 2000 - 2010 period.

A comparison of GDP dynamics by ultimate demand components shows that investment expenditure is subject to fluctuations to a much greater extent than consumer expenditure. Consequently, an analysis of dynamics and structure of changes therein helps understand the trends in economic activity. In analyzing the dynamics of investments in the Russian economy it is necessary to track the course of gross savings changes within the GDP. On average, in the past ten years investment expenditure was approximately 16.0 percent of the GDP. While the 1992 - 1998 recession occurred in the period when the share of investments in fixed assets was diminishing, the economic growth in 1999 - 2001 was based on a shift in resources in favor of the investment component. A distinctive feature of the rise in the Russian economy was the increase in the efficiency of utilization of gross savings in fixed assets. Economic growth encouraged the process of transformation of savings resources into investments. The share of investments in fixed assets in the GDP grew to 17.7 percent in 2001 as against 14.1 percent in 1998.

FIGURE 11

Share of Investments in Fixed Assets in the GRP of Federal Super-regions, in %

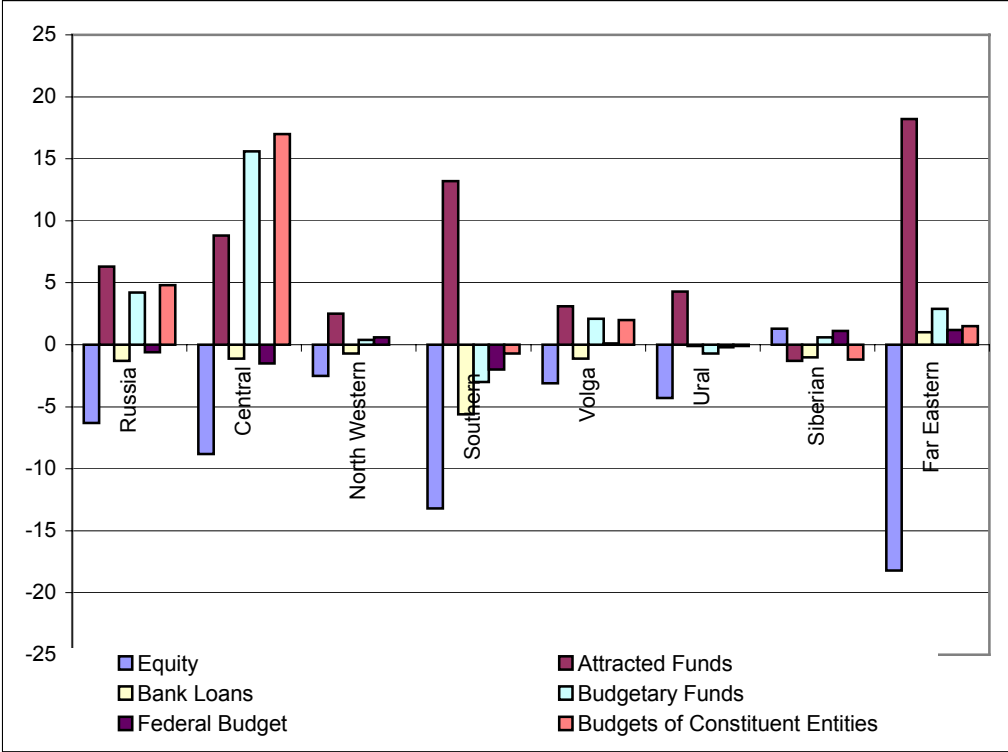


The past three years have been distinguished by a growth in investment activity against the background of continuing reduction in allocation of budgetary funding for investments. Own capital of companies remains the main source of funding investments in fixed assets. The quick growth in investments in fixed assets in 1999 - 2001 was accompanied by an increase in profitability of the economy. In 2000 profitability of production in the economy on the whole rose up to 18.9 percent and profitability of assets rose up to 7.8 percent. Better financial condition of enterprises and a growth in effective demand were the factors that stimulated an

increase in the share of accumulation fund in the sources utilized to finance investments in fixed assets. While in the 1996 - 1998 period profits accounted for less than 25 percent of enterprises' equity directed to investments, in 2000 - 2001 this share rose up to 50 percent.

FIGURE 12

Changes in the Structure of Investments in Fixed Assets of Federal Super-regions by Sources of Funding in 1999 - 2000, in % for the Period



1.1.3 Dynamics of Ultimate Consumption and Standard of Living

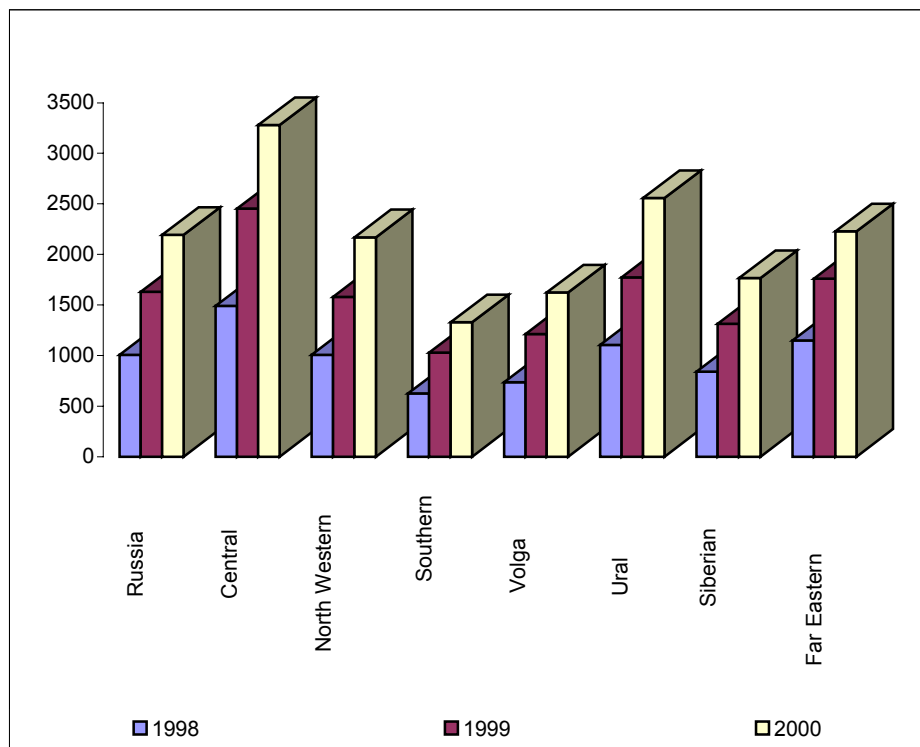
The growth in revenues of the economy has had considerable effect on the proportions of ultimate consumption in the GDP. Throughout the 2000 - 2001 period gross savings of fixed capital were the quickest to grow out of the components of ultimate consumption of the GDP. Under the conditions of a rising level of business activity in the Russian economy the growth in investment demand provided for almost one fourth of the growth in the physical volume of the GDP. However, while the GDP resources were redistributed in favor of the investment component and the rest of the world, a trend towards lower expenses on ultimate consumption of material benefits and services started to gain strength since 2000.

In 1999 production was growing against a background of low consumer demand caused by a sharp decline in personal incomes due to the rouble devaluation. In 1999 real personal incomes were 72.2 percent of the pre-crisis 1997 level. The existing level of effective demand in the consumer market limited the possibilities of further increase in the scale of production of goods and services. As a result total expenses on ultimate consumption diminished by 3.5 percent over the year. In the circumstances the consistent realization of the government's policy of increasing wages and pensions had a positive effect on the nature of economic

growth. Starting with the 4th quarter of 1999 the dynamics of expenses on ultimate consumption of households has been distinguished by a stable growth trend.

FIGURE 13

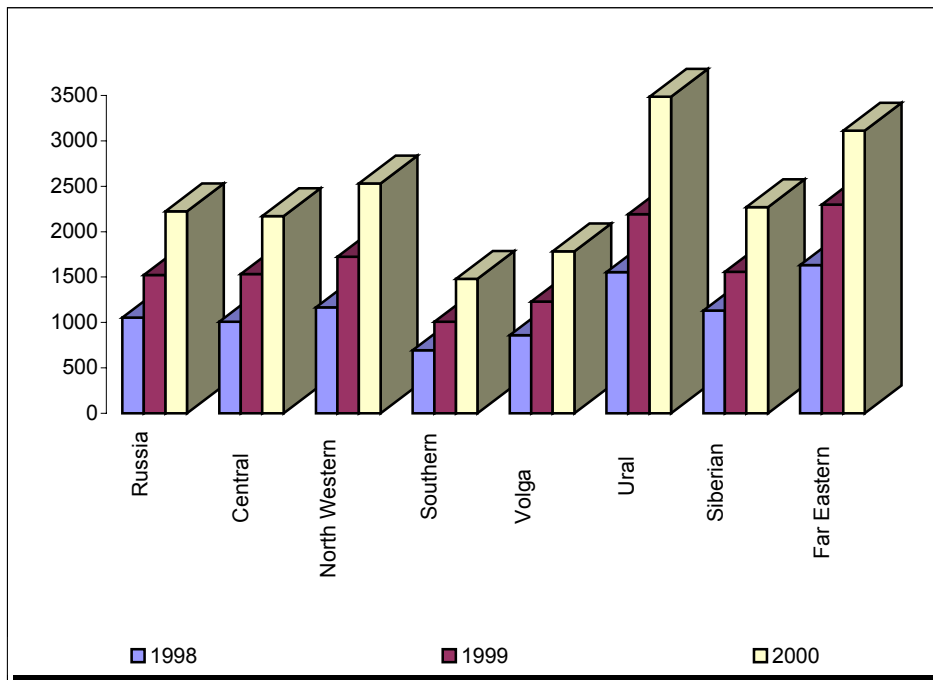
Average Per Capita Monetary Personal Incomes by Regions of Russian Federation, RUR



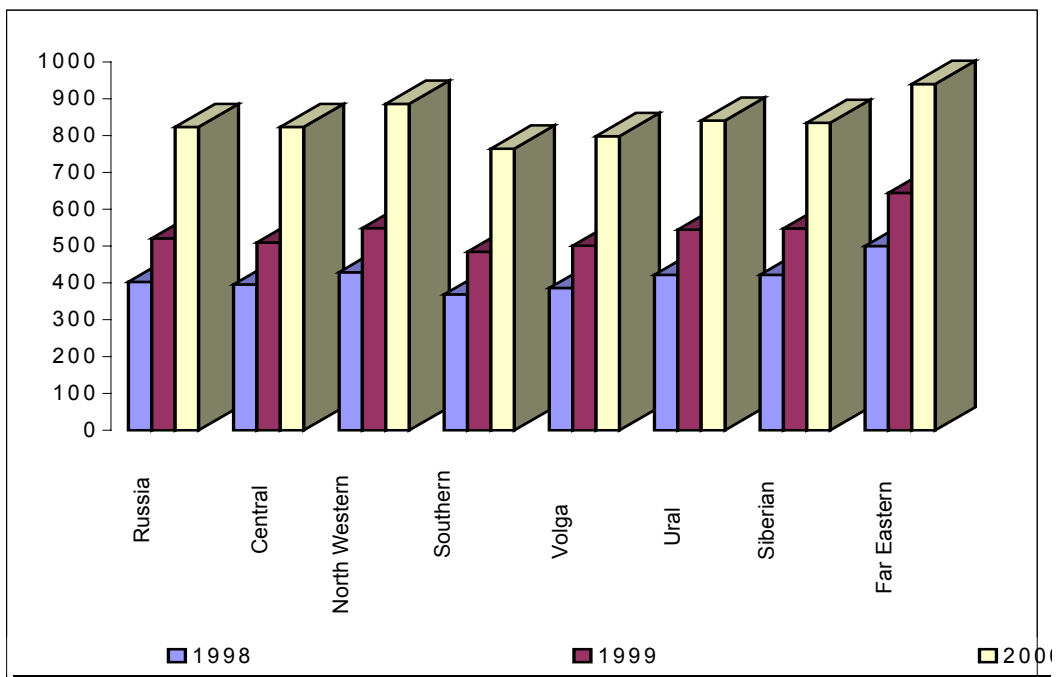
Changes in the external economic conditions became one of the factors that caused a shift in economic policy priorities towards expansion of internal demand. A growth in export revenues of the economy has had a significant effect on the nature and proportions of production and ultimate consumption. The growth potential established owing to active investment activities and the growth in revenues of the business have allowed to resolve the existing social problems. In 2001, under the conditions of a rather stable tendency towards a growth in wages and pensions, real incomes of the population grew by 5.9 in the course of the year. The share of expenses on ultimate consumption grew by 3.7 percentage points in comparison with the 2000 level; this is entirely a result of quick growth in household expenditure. Almost three fifths of the GDP growth in 2001 result from a growth in expenses on ultimate consumption. It should be pointed out that an analysis of development of the Russian economy over the past ten year period demonstrates that in the condition of the existing dynamics the amount of expenses on ultimate consumption of households attained the pre-reform 1991 level. The population with monetary revenues below the subsistence level reduced in the course of 2001 to 27.2 percent of the total as opposed to 30.2 percent in 2000.

FIGURE 14

Allocated Wages by Regions of the Russian Federation, RUR



Allocated Monthly Pensions (with Consideration of Compensation) by Regions of the Russian Federation, RUR



Dynamic expansion of retail trade turnover and an increase in production of national consumer goods serve as the best indicator of positive changes in the living standard of the population. According to estimates, the increment in expenses on ultimate consumption of households is 8.1 percent. In comparison with year 2000 the turnover of retail trade increased

by 10.8 percent. As personal incomes grow, purchases of non-food products grow especially quickly. The retail turnover in foodstuffs grew by 7.4 percent in 2001 in comparison with the similar prior year period, and turnover in non-food products increased by 13.7 percent. As the consumption level gradually recovers, turnover of trade enterprises grows at a higher rate than sales volumes in foodstuff and dry product markets. The intensive growth in consumer demand has positively affected the dynamics of increase in profitability of retail trade and investment activities in this sector of the economy.

A favorable situation in the internal market reinforced the motivation for development and expansion of production. While revenues from production and exports remained at a high level since 1999, a trend towards an increase in the share of savings appeared in the structure of ultimate demand for the first time in the reform years. Economic growth in 1999 - 2001 ensured fulfillment of obligations in respect to financing of budgetary expenses and servicing of the state debt without unscheduled borrowings in the internal and external financial markets. The growth in investments in fixed assets retains predominant influence on the dynamics of production. The share of gross savings in the GDP consistently exceeds the 2000 level.

Despite of positive dynamics of investment growth, under the existing technological, reproductive and age structure of the fixed assets, the investments are clearly insufficient for an active industrial policy.

Conclusions

A survey of structural changes in the GDP, industrial production and investments in fixed assets has been performed on the basis of generalized statistical data. The dynamics and structure of social and economic indicators have been surveyed in terms of branches and regions. The results of a macroeconomic and branch analysis have allowed to estimate the relative influence of various factors on the dynamics and structure of production and investment activities in federal super-regions.

An analysis of changes in macroeconomic proportions of the Russian economy has allowed to establish a number of basic factors that affect significantly the nature and dynamics of transformation shifts. Understanding general trends in the development of the Russian economy has helped to get a more clear idea of the changes in the role and contribution of individual territories to the gross regional product (GRP) and to define the specific features of regional business activity.

Russian economic development occurs against a background of reducing differentiation of the system of social and economic indicators by regions. The general signs of regional economy revival in the 1999 - 2000 period include a recovery of production and investment growth rate, increase in interregional demand and expansion of internal market, increase in demand for workforce and reduction in unemployment, and an improvement of the standard of living.

A comparative analysis of general economic indicators of the country's regional development shows that the nature of investment activity is in defining dependence on the structure of the economy and dynamics of financial results of the activity. Regions with a high degree of investment activity are generally well developed. The GRP and per capita amount of industrial production in these regions is on average significantly higher than the average Russian figures. Regions with medium level indicators of investment activity are characterized by less developed industry and greater employment of the population in agriculture.

It is advisable to view differences between investment activities in various regions via the branch structure of regional economies and changes in the system of financing investment activities. An analysis of general economic factors has demonstrated that the most difficult situation remains in the territories with a high concentration of processing industries, first of all labor-intensive machine building, including defense branches, light industry and, partially, food-processing industry. The regions with a high degree of concentration of fuel industries, ferrous and nonferrous metallurgy, certain export-oriented sub-branches of the chemical and forestry branch. Besides, in respect to territories, specialization on a single branch and an overall insufficient level of economy diversification constitute an additional business risk factor.

2. Economy of the Republic of Altai in 1998 - 2001

2.1 Basic Social and Economic Characteristics of the Republic of Altai

General information. The Republic of Altai is a part of the Siberian Super-region of the Russian Federation. The territory of the republic extends for 92,6 thousand km². Gorno-Altaysk is the capital and the sole city of the entire republic.

As of 1 January 2001, the population of the Republic of Altai was 205,5 thousand people of which 53,1 thousand (25.8%) people are city dwellers and 152,4 thousand people (74.2%) live in the countryside.

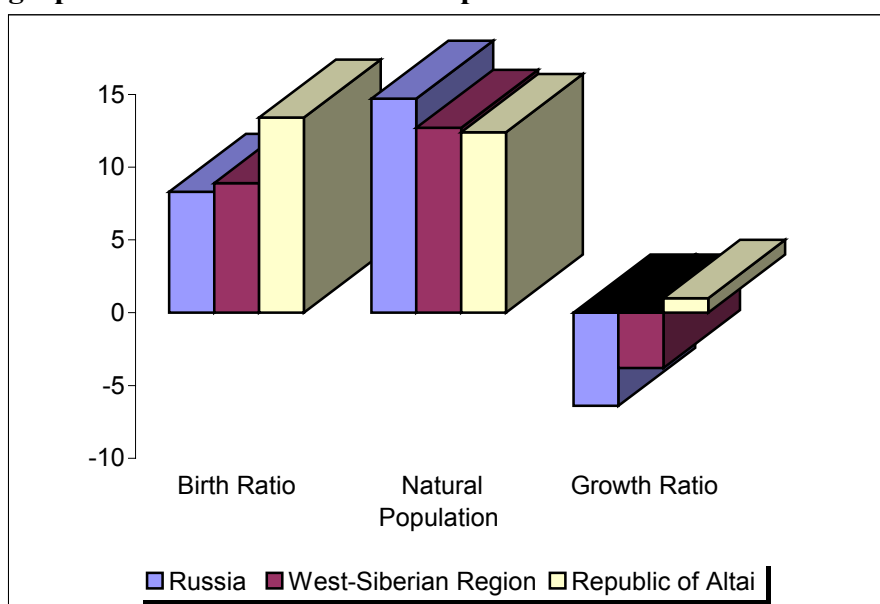
The population is unevenly distributed on the territory of the republic. Some 50% of the population live in Gorno-Altaysk, Maimino and Shebalino districts that account for 9% of the area of the republic.

Ethnically, the population of the Republic of Altai is fairly diversified. Over 100 nationalities and ethnic groups live here. The national minority population amounts to 60 thousand people comprising 30% of the population of the republic. The Russians dominate in number accounting for 60% of the entire population.

In 1998 – 2000, positive demographic changes were noted. In 2000, natural population growth was noted in the republic. The registered number of infants exceeded by 4.7 % the number of those born in 1999. Infant mortality rate decreased. The Republic of Altai ranks sixth among the constituent entities of the Russian Federation by number of infants born per 1000 people. It should be noted that demographic situation in the Republic of Altai is better than in Russia at large or the Western Siberia region: birthrate in the republic was higher than in the Western Siberia region, while the mortality rate was below that in the Western Siberia region and the Russian Federation.

FIGURE 15

Basic Demographic Characteristics of the Republic of Altai



Over the last few years, migration routes of the population remain unchanged. The population growth caused by migration has been decreased by 16% as compared to the previous year. According to the Migration Service the number of involuntary emigrants registered in 2000 increased by 16.0% to amount to 318 persons. The majority of the involuntary emigrants moved to the republic from Kazakhstan and Uzbekistan.

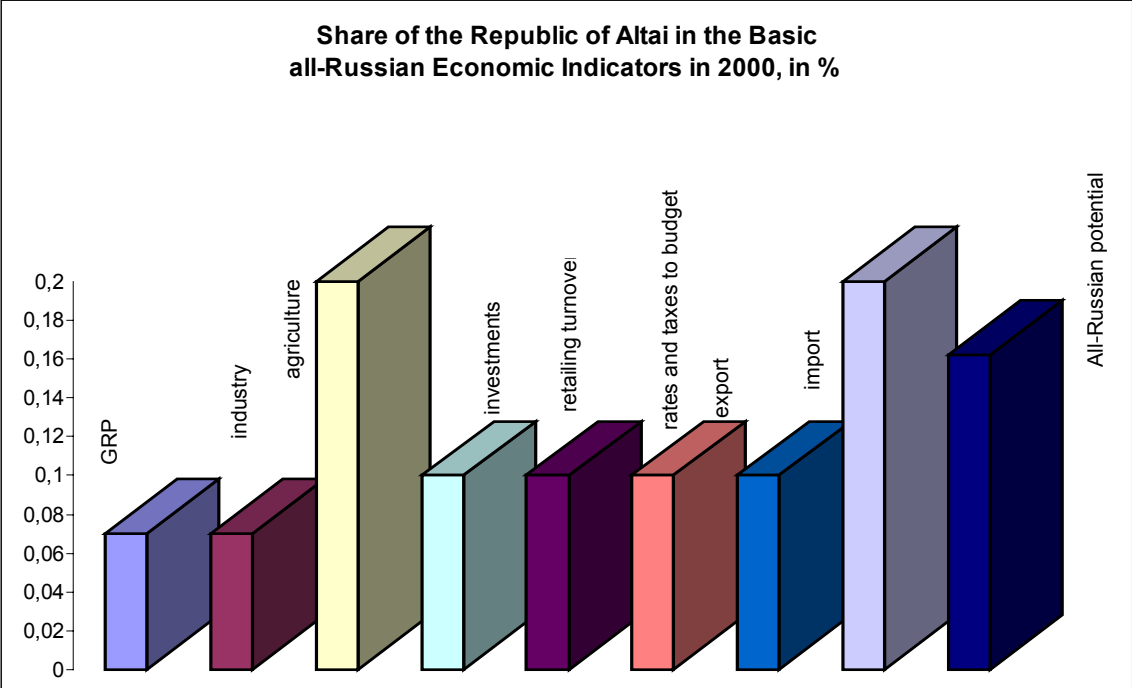
2. 2 Real Sector of Economy.

2.2.1 Economy Structure of the Republic of Altai

In analyzing economy of the Republic of Altai it should be noted that originally the republic used to be listed among the regions of Russia running the sectional structure of production inherited from the Soviet Union which was found to be extremely vulnerable in the competitive environment. It is well known that at the inception of the reforms in Russia, the regions with the largest proportion of agricultural industries became most depressed. In 1992, the aggregate proportion of agriculture and processing sectors of consumer goods industry and food processing industry of the republic exceeded the gross resources by 40%.

The structure of the economy of the Republic of Altai was basically focused on utilizing the potential of local mineral and primary resources as well as export of the majority of products manufactured. At the same time the economy of the republic depended almost completely upon imported high-processing products. As a consequence of a high inertia factor the breakup of traditional economic links resulted in an extremely poor production behavior. Generally, the majority of the enterprises of the republic had no alternative system of supply and disposal of products.

FIGURE 16



Obviously, the industrial and geographical settings of the region made the economic problems worse. There is virtually only one highway running between the Republic of Altai and the main territory of Russia. The federal highway named *Chuisky Trakt* (the Chu Road) leads

from north and south-east of the republic crossing six of 10 regions and linking to the neighbor regions. In the Republic of Altai motor transport is of vital importance in securing sustenance and performance of the economic mechanism. This is virtually the sole means of freight and passenger transport in the republic. Under profound economic reforms limited accessibility and remoteness of the region from the main transport routes of communications resulted in localization and growing isolation of the internal republican market.

2.2.2 Economic crisis in the republic in 1992-1997: trends and factors

At the first few years of the reforms the economic recession trends in the Republic of Altai were similar to those in Russia at large. Between 1992 and 1996, the recession in the republic was deeper than the average level in the country. In 1996, the industrial output accounted for about one third of the 1990 level (50% in the Russian Federation), 46% in agriculture and 40% in housing construction. Production of GRP per capita accounted for 46% of the 1994 average level in Russia, unemployment rate reached 18.4% of the economically active population of the Republic of Altai. The Republic of Altai ranked 68 in money income per capita among the constituent entities of the Federation. By 1996, the population with income being below the subsistence level accounted for 45.1% of the total population of the republic.

Under the circumstances of general crisis the economic structure of the Republic of Altai was found to be inadequate to promptly transform its production sector to suit the market requirements. The basic feature of the republic's economy is small percentage of industrial output. In 1998, industrial output accounted for 4.5% of the GRP. The Republic of Altai ranks the last in industrial output per capita among the regions of the Russian Federation.

TABLE 5

Republic of Altai among the constituent entities of the Russian Federation in manufacturing of several products in 2000

| Product | Place |
|---|--------------|
| Electric power production | 83 |
| Industrial wood production | 53 |
| Production of lumber | 54 |
| Production of prefabricated reinforced concrete | 76 |
| Building brick production | 74 |
| Production of textiles | 46 |
| Production of knitted goods | 60 |
| Panification | 75 |
| Production of alcoholic beverages | 74 |
| Production of meat | 60 |
| Production of butter | 66 |
| Production dairy products | 75 |
| Products of agriculture | 70 |
| Gross grain harvest | 67 |
| Gross potato harvest | 71 |
| Gross harvest of fruits and berries | 57 |
| Production of wool | 17 |
| Production of honey | 52 |

Source: State Committee for Statistics of the RF

Traditionally, the industrial development of the Republic of Altai was focused on utilizing natural and primary agricultural resources. The processing sectors of consumer goods industry and food processing industry account for 2/5 and nonferrous metallurgy for 1/4 of the gross industrial output. Outdated technologies do not allow high-quality and competitive products to be manufactured. Lack of experience and specialists in marketing has an adverse effect on the economy. In addition, a detrimental effect is exerted by a severe situation in agriculture that is the primary resource of food processing industry as well as basic customer for agricultural machinery maintenance.

The decline in production was initiated by exacerbation of crisis in the investment business. In 1999, a free economy zone, first in Russia, was set up on the territory of the Republic of Altai. With the view to organize and develop joint economic activity with foreign enterprises the government of the republic offered additional benefits to foreign and domestic investors within the framework of the EER (ecological and economic region) Altai.

As a tool for tax planning, soft taxation schemes for legal entities were designed at the ecological and economic region Altai. The adopted legislation allowed enterprises and organizations to be immune from taxes due to the republican and local budgets. However, the hopes of inflows of domestic and foreign capital failed. In spite of the attractive legislation, investment activity in the republic gradually decreased. The EER Altai had no influence on the business activity level.

In 1996, fixed capital expenditures accounted for just 28% of the 1990 level, and the republic ranked 77 by fixed capital expenditure among the constituent entities of the Russian Federation. In 1996, social and economic performances of the republic were significantly below the average figures in Russia, and the Republic of Altai was listed among 20 regions with the lowest production setback.

In 1997, the growth in GDP and industrial output was noted and the decline in the investment sphere was suspended. The growth in the production output had an impact on the growth in population's earnings and situation at the labor market. In addition, these processes had an impact on the social and economic situation of the Republic of Altai. Slightly reduced was the decline in production of goods in the republican economy. An intensive growth in nonferrous metallurgy output and a slight growth in agricultural production had a positive impact on the economy. The growth in real earnings of the population in 1997 accounted for 16.0% (total in Russia – 6.0%) and real wages accounted for 17.0%. The real amount of allocated pensions increased by 43.2% as opposed to 1995. The increase in earnings resulted in a significant decrease in poverty. The situation at the labor market remained most difficult. The unemployment problem still showed some forms of severe crisis due to continuing slowdown in business activity and isolation of the local labor market. In 1997, the unemployment level accounted for 18.5% of the economically active population and remained at the level of the previous year, while the official unemployment level increased by 0.2 percentage points and exceeded significantly the average level in Russia and similar indicators of the Western Siberia and neighboring Eastern Siberia regions.

In spite of some positive changes noted in production, institutional structures and life standard of the population, the total assessment of the investment potential in 1997 remained unchanged. The Republic of Altai was rated 83 among the constituent entities of the Russian Federation.

2.2.3 Specific features of economic recovery in 1998-2001

To resolve the problem of recovering from economic crisis in the republic, the governmental authorities had to take decisive actions.

In 1998, the government of the Republic of Altai developed a program of measures aimed at improving the economic situation. The program specified top-priority trends of development and specific measures aimed at supporting specialized industries and prospective productions. Unfortunately, a new wave of crisis in the Russian economy set back the implementation of active restructuring of the republic's economy. A sharp decline in internal and external demand had an adverse effect on the economy of Russia at large and some regions. The living standard was adversely effected by the growth in consumer prices caused by devaluation of the ruble. In general, real earnings in Russia in 1998 dropped by 16.2 %, while the depressed regions suffered even a worse decrease in living standard. In 1998, real earnings of the population of the Republic of Altai dropped by 28.0%, the amount of allocated pensions decreased by 44.0%. Almost half of the population found themselves beyond the level of poverty.

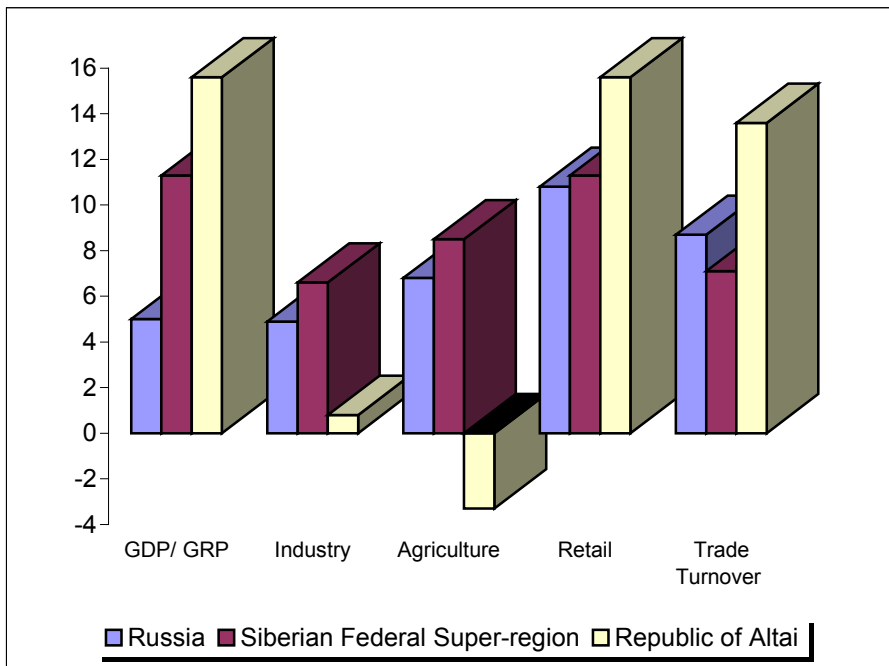
The decrease in external demand for nonferrous metals and products of maral deer and reindeer breeding – primary items of exports and interregional trading – aggravated the production setback. In 1998, the GRP of the Republic of Altai decreased by 9.4%, while the industrial performance dropped by 26%, agricultural indicators dropped by 12.0%. The situation at the labor market was aggravated. Unemployment increased up to 18.5%.

Under the difficult situation of 1999 – 2000 the government of the republic pursued a fairly efficient policy of fighting the effects of crisis. New acts of law on investment were adopted; public purchases were conducted on a competitive basis; landed property was allocated at joint stock companies, former collective farms; the accounts of the budget were transferred to the Treasury, imputed earning tax and sales tax were introduced. The budgets of 1998 and 1999 had a qualitatively new structure as opposed to that of 1997. Expenditures of the republican budget were reduced more than by half. Over 1999 and 2000, tax revenues almost doubled; in 2000, tax revenues amounted to over RUR 100 million. The federal budgetary provisions increased substantially. In 2000, some RUR 420 million were allocated to the republic as opposed to RUR 175 million in 1999.

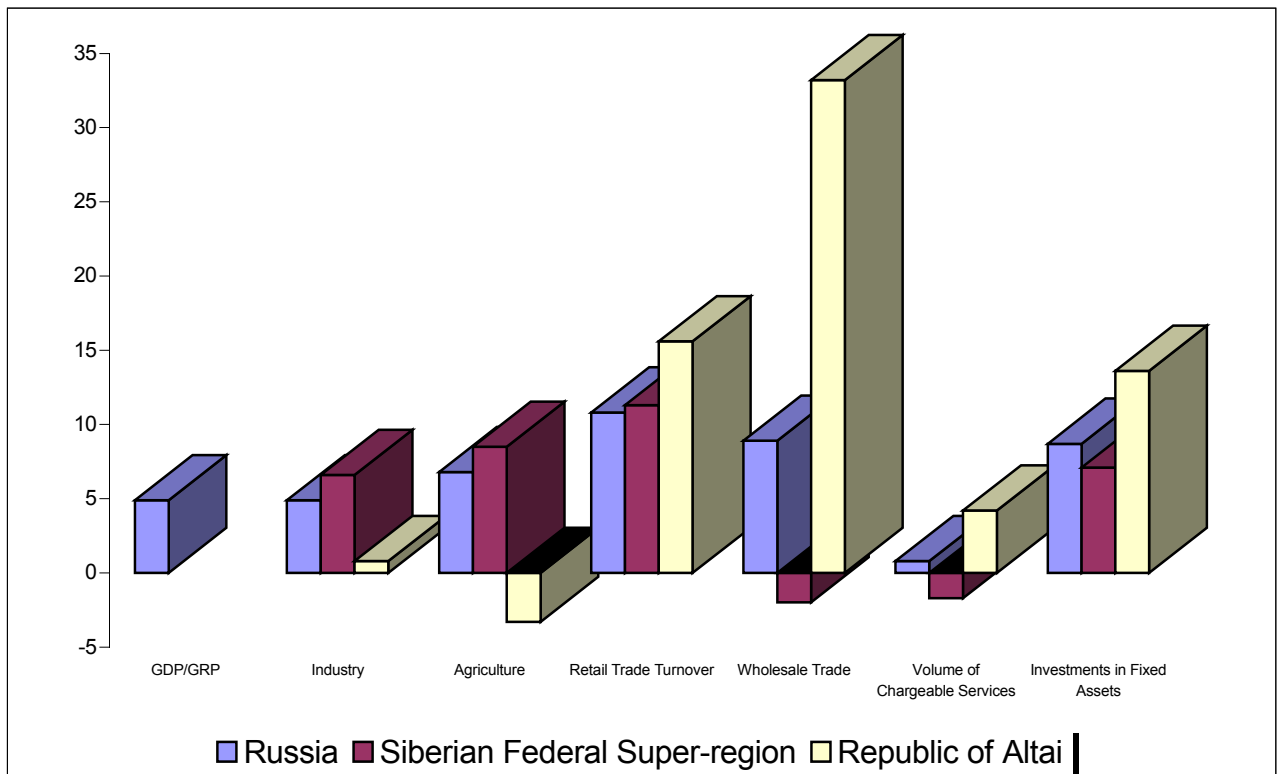
In 2000, wage arrears decreased by virtue of additional earnings as well as financial support from the federal government. It was noted in 2001 that wages to public service employees and children's allowances were paid more regularly and in full. By the end of 2001 almost all wage arrears were settled and arrears on children's allowances was reduced by half. Analysis of the economic development of the Republic of Altai in the post-crisis period showed some positive factors. Since 1999 the gross regional product has been growing steadily. Economic growth is based upon the increase in business activity almost in all economic sectors. In 2000, industrial output increased almost by 1.8 times and agricultural output increased by 6.3 times as opposed to 1998. In 2000, freight traffic by motor transport enterprises increased by 24.1% and retail business turnover increased by 12.2 % with the production of goods maintained at a positive level. In 2000, however, regardless of such a high growth rate the goods turnover only accounted for 90.7% of the 1998.

FIGURE 16

Basic Indicators of Economic Development in 2000, in comparison with 1999, %



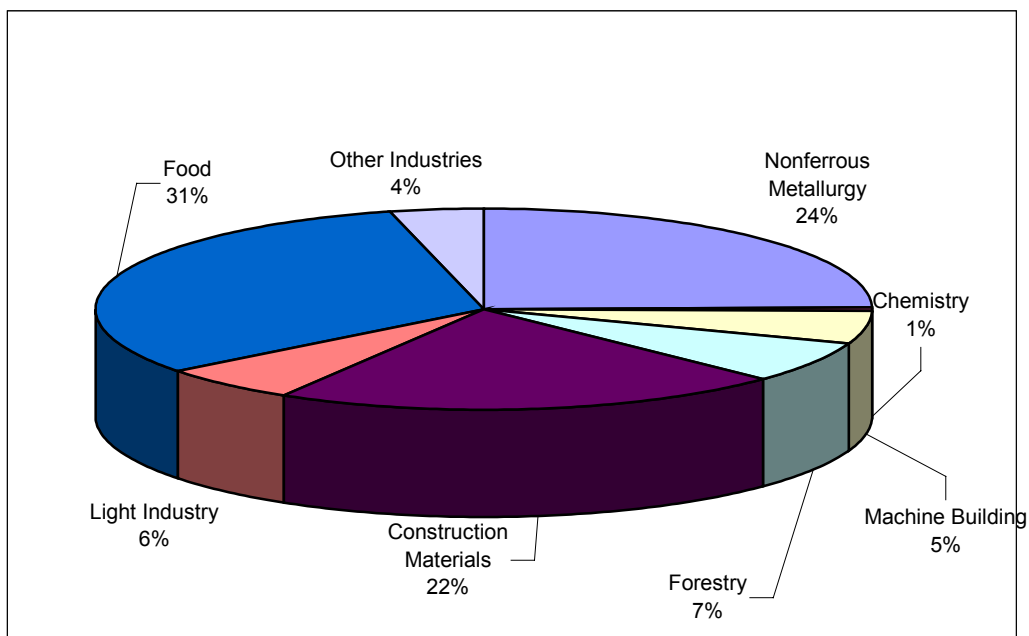
Change in Production Indicators by Industries in 2001, in comparison with 2000, %



The industry of the Republic of Altai is represented by consumer goods industry, food processing industry, production of construction materials, woodworking, mining and nonferrous metallurgy.

FIGURE 17

Industrial Output Structure of Republic of Altai in 2000, %



As the demand for domestic products increased after the crisis in August 1998 these industries were boosted to grow. In 1999-2000, the growth rate in the republic was faster than the average rate of the Russian Federation.

TABLE 6

Industrial output performance

| | RUR billion | in % versus previous year | | | |
|----------------------|-------------|---------------------------|-------|-------|------|
| | | 2000 | 1999 | 1998 | 1997 |
| Russian Federation,. | 5881 | 104,9 | 109,1 | 108,1 | 94,8 |
| Siberian Region | 613,4 | 106,6 | 109 | | |
| Republic of Altai | 468 | 100,8 | 107,3 | 171 | 74 |

Source: State Committee for Statistics of the RF

The period between 1999 and 2001 saw an intensive growth in production of the goods that traditionally used to be salable at the Russian market. For instance, cheese production increased by 1.7 times in 2000 as opposed to 1998. Production of medicines at the republican enterprises increased by 74.7% as the trend of import substitution increased.

The Republic of Altai is an agrarian republic. Agriculture prevails in the production structure and accounts for over half of the gross industrial output of the republic. Livestock farming is the principal branch of the region's agriculture. Grassland occupies almost 75% of the agricultural land. Sheep farming and horse-breeding are traditional core activities in Altai. Sheep are ranches in 7 districts of the republic. The total sheep number of all categories of farms exceeds 300 thousands, 100 thousand goats and 70 thousand horses.

Of prime importance is reindeer breeding for antlers. This branch of industry provides the world-unique product, antlers of maral deer and sika deer. The Republic of Altai is rated at the top of the Russian producers of maral deer antlers (75% of the all-Russian output), goat wool (6.5%) and lamb wool (1.4%).

At present, the number of maral deer in the Republic of Altai has exceeded 27 thousand heads, and 8 thousand heads of sika-deer. As a principal export-oriented production the maral deer breeding generates a significant amount of hard currency to the republic .

The situation improved in 1999-2000 after the severe crisis of livestock breeding in 1996 - 1998. In 2000, the growth in meat production achieved 23.5% as opposed to 1999, which resulted from a better forage supply.

TABLE 7

Production of basic agricultural products

| | 2001 | in % versus previous year | | | | |
|---|------|---------------------------|-------|-------|------|------|
| | | 2001 | 2000 | 1999 | 1998 | 1997 |
| Meat, including 1st grade by-products, tons | 729 | 43,7 | 123,5 | 75,8 | 87,3 | 59,4 |
| Dairy products in terms of milk, tons | 165 | 29,0 | 92,8 | 200 | 36,7 | 53,5 |
| Gross harvest of grain and bean cultures: thousand tons | 15,4 | 75,4 | 150,3 | 141,9 | 166 | 54,2 |

Source: State Committee for Statistics of the RF

Oats and barley are principal grain crops in the republic. Corn for silage and grass crop is also raised. In 1998-2001, a growth in croppage of bean cultures was observed. The harvest of bean cultures increased by 2.1 times as opposed to 1998. In 2000, 20.4 thousand tons (after development) of grain and bean cultures was harvested thus accounting for 150.3% of the 1999 level. The output in other branches of grass production was reduced while the grain crops were fairly heavyweight. In 2000, 37.2 thousand tons of potatoes and 12.9 thousand tons of vegetables was harvested, which consequently accounted for 79.7% and 81.5% of the crop of 1999 .

In the post-crisis period the Republic of Altai considerably boosted its foreign economic activity (FEA). Over 2000, foreign trade turnover reached US\$ 21,791.3 thousand. The turnover increased by US\$ 8,218.8 thousand or by 1.4 times in comparison with 1999. Export accounted for 95.5% and import for 4.5 % in the turnover structure. This ratio almost remained the same as compared to 1999. The black ink of foreign trade balance was US\$ 19,809.3 thousand.

In 2000, export of goods reached US\$ 20,800.3 thousand (95.5% of the turnover) and increased by US\$ 6,418.9 thousand, i.e. by 1.4 times, as opposed to the same period in 1999. The volume of export to other than CIS countries increased by 2.1 times, while the exports to the CIS decreased by 3.9 times.

Traditionally, the major part of export trade turnover of the Republic of Altai is antlers of maral deer and reindeer. The principal consumer of antlers is South Korea. In addition, exported goods include hides, lamb's wool, goat's wool, bracken, lumber and timber.

Over the last few years the structure of export of the Republic of Altai extended through export of mercury, tungsten and molybdenum concentrate, medical-technical raw materials and other raw materials (fir oil, cedar oil, sea-buckthorn oil, herbs extracts, etc.) for the purpose of perfume and cosmetic industry. The major exporter are the South East Asia, namely South Korea, Mongolia, China, Japan, etc..

In 2001, the volume of import was US\$ 991 thousand. The volume of import grew by 1.2 times as opposed to that of 1999. Food products account for 74.5% of the import structure. The import of food products amounted to US\$ 738,0 thousand and almost remained unchanged as opposed to 1999.

The principal partner of the Republic of Altai in foreign trading is Mongolia accounting for 67% of the total volume of export and 82% of the total volume of import. Basically, Mongolia imports various equipment and machinery. In exchange for the exported equipment the Republic of Altai imports food products (meat) and agricultural raw materials (hides, etc.).

A considerable volume of export goes to the South East Asian countries. Among major foreign trade participants in the Republic of Altai are ZAO Gorniy Proekt-A (33.7% of the total turnover), OAO Gorno-Altai vneshtorg KO (12.1%), VEPO ASOKHRA (11.3%), ZAO Altaifarm, etc.

The growth in earnings generated from foreign trading as well as extended interregional trading had a positive impact on the GRP of the Republic of Altai.

The growth in production output accounted for positive changes in social and economic situation. First and foremost, the situation at the labor market was changed. The unemployment rate tended to slow down. According to the Ministry of Labor and Social Development, a demand for new employees arose in the region. Development of small businesses also accounted for the employment growth.

Due to active social policy pursued by the governmental authorities the living standard in the Republic of Altai tended to grow. Since 2000 the real earnings of the population tended to grow. The real earnings almost increased by 2% in comparison with 1999. In 2000, the gross money income of the Altai population increased by 1.4 times as opposed to 1999, while the gross expenditures increased by 1.47 times. Average per capita earnings in 2000 amounted to RUR 14,409. The republic is rated 66 by this indicator among the constituent entities of the Russian Federation.

In December 2000, the subsistence level was RUR 1,019 per capita which was higher by 4.6% than the indicator of the same month of the previous year. In 2000, the number of people with earnings being beyond the subsistence level was reduced by 24.6 people as against 1999. Analysis of the social situation allows one to come to recognize the need for urgent reforms of the social security system in the republic in terms of increasing its efficiency with less budget expenditures. The average number of those who need social protection is 46%, including 53% of families with children. They account for 15% of the total population of the republic registered at the social security offices as those in need of social protection. The most complete record of those who need social protection is kept at Maimino and Ust-Kan districts; minimum record – in Shebalino and Ust-Koksa districts.

In the structure of money income there is a trend to decrease in cash in hands and increase in the amounts spent on goods and services, dues and taxes. In 2000, the purchase power of the average per capita money income increased for all types of food products except for flour.

TABLE 8

Republic of Altai in Comparison with other Regions of Russian Federation by various performances

| Performance | Place |
|-----------------------------------|--------------|
| Average per capita earnings | 66 |
| Average per capita expenditures | 75 |
| Volume of payable public services | 78 |

| | |
|---|----|
| Earnings generated from communication services received by population as per one person | 71 |
| Commissioning of residential houses for 1000 people | 67 |
| Food consumption per capita | |
| Meat and by-products | 4 |
| Milk | 20 |
| Eggs | 64 |
| Sugar | 70 |
| Vegetable oil | 71 |
| Potatoes | 27 |
| Vegetables | 61 |
| Bread | 1 |

Source: State Committee for Statistics of the Russian Federal

Shopping increased gradually as the earnings increased. In 2000, the growth in retail trade turnover reached 12.2%, in 2001, 15.6%. The growth in earnings of the population accounts for the growth in nonfood items in the structure of sales as well as the increase in sales volume of trading enterprises. In 2000, nonfood items accounted for up to 45% of the retail sales, while in 1999 it was 41%. Seventy four percent of retail turnover in 2000 was achieved by trading companies and 26% by individual sellers. However, regardless of the positive trends of development the living standard failed to reach the pre-crisis level.

The financial indicators of enterprises increased as the business activity grew. From 1999 a positive dynamics of growth in financial performances of enterprises and organizations has been noted in the republic. In 2000, the financial performance increased by 5.4 times as opposed to 1999, while the number of unprofitable enterprises and organizations dropped to 54.5 % in comparison with 68% in 1999. Over 2001 the financial performance of the enterprises and organizations of the republic increased by 2.6 times, while the number of unprofitable enterprises accounted for 45.8% as opposed to 2000.

TABLE 9

Changes in rating (among regions of the Russian Federation) of Republic of Altai by basic characteristics of social and economic development over 1996-2001

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|----------------------------|------|------|------|------|------|------|
| Investment potential | 83 | 83 | 82 | 83 | 82 | 82 |
| Labor potential | | | 80 | 81 | 79 | 78 |
| Consumer potential | 76 | 79 | 80 | 79 | 78 | 77 |
| Infrastructure potential | 74 | 78 | 78 | 73 | 71 | 71 |
| Industrial potential | 82 | 81 | 83 | 82 | 85 | 84 |
| Innovation potential | 89 | 75 | 77 | 79 | 79 | 79 |
| Financial potential | | | 80 | 75 | 79 | 80 |
| Institutional potential | 78 | 76 | 78 | 79 | 73 | 76 |
| Primary resource potential | 79 | 79 | 69 | 61 | 61 | 61 |
| Intellectual potential | 84 | 78 | | | | |

After a long-lasting pause in investment activity in 1999 the growth in fixed capital investments in the Republic of Altai accounted for 16.0%, while the total fixed capital

investments in Russia at large accounted for 4.5%. In 2000, the Republic of Altai was rated 49 by per capita investments among the constituent entities of the Russian Federation. The growth in investment activity was conditioned by changes in investment flows between various sectors and branches of the economy. In 1998 – 2000, the dominant majority of investments were earmarked for the development of routes of transport communications and communication facilities. The federal center and republican authorities pay close attention to the solution of transportation problems. In 1999, over half of the fixed capital investments were earmarked for highway engineering. In 2000, the growth in industrial output was still dependant upon the growth in investment activity. At the same time, it should be noted that the growth in investment activity is supported by increased federal budgetary financing for this purpose. Given the limited internal recourses the republican budgetary financing of investments remains negligible.

TABLE 10

Changes in investment risk in Republic of Altai over 1996-2001 (Republic of Altai among other regions of Russia)

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|--|------|------|-------|-------|-------|------|
| Risk integral assessment | 58 | 75 | 79 | 54 | 52 | 40 |
| Including basic items | | | | | | |
| Social | 17 | 17 | 85 | 52 | 63 | 50 |
| Economic | 69 | 66 | 57 | 74 | 25 | 14 |
| Financial | | | 81 | 78 | 79 | 78 |
| Ecological | 15 | 15 | 2 | 4 | 5 | 3 |
| Political | 69 | 85 | 77 | 74 | 81 | 81 |
| Legislative | | | 29 | 16 | 10 | 5 |
| Average weighted index of investment risk in Republic of Altai (Russia =1) | | | 1,476 | 1,025 | 1,093 | 0,99 |

In spite of a favorable legislation environment developed for external investors, neither domestic nor foreign investments were noted to inflow in the republic within the entire period of free economy zone. Naturally, in this respect the registration of new participants of EER Altai was terminated since March 2000, and in August 2000 the President of the Republic of Altai issued a decree on cancellation of VAT tax benefits and the State Assembly was requested to introduce certain amendments to the law.

It is hard to make the unique assessment of the changes in taxation. On the one hand, the development of an attractive legislation regarding investments in the Republic of Altai is far ahead of the investment potential of the territory. Active work on legislation encouraged the creation of a favorable investment environment. In 1996-1997 the Republic of Altai was rated 75 by legislative investment risks among the constituent entities of the Russian Federation, while in 2001 the republic was rated in the top five regions by the most favorable legislation. Over the last four years, the risks regarding economic, social and ecological component of the integral investment risk indicator have been diminished. On the other hand, the investment potential remains the same and the republic is rated 82 among the constituent entities of the Russian Federation. In spite of a certain success achieved, the republican economy has no stable revenue base and a high amount of the state aid for the region account for high financial risks. The experience over the last few years has shown that the tax benefits has

failed to increase budgetary earnings and its further usage will contradict the general trends of the Russian legislation.

Conclusions.

Analysis of the development of the Republic of Altai over the period between 1999 and 2001 shows that changes in macroeconomic conditions of reproduction and environment at the internal Russian market have boosted economic development and eased social tension.

The economic development of the Republic of Altai in 1999 – 2001 was exposed to the influence of the factors and trends that are typical of the Russian economy. The recovery of the industrial production and growth in demand for investments was characteristic features of the development. Changes in the conditions at the internal regional and interregional markets as well as the growing demand for domestic products were supported by the growth in business activity in construction industry.

Regardless of the economic recovery the Republic of Altai remains in the list of depressed regions. The living standard remains the basic problem of the republic. Average per capita indicators of the GRP reproduction volume, fixed capital investment volume, foreign trade turnover volume and financial security indicators remain far below the average level in Russia. Also, a higher percentage of low-income population in comparison with the average Russian indicator.

Among indicators showing an adverse financial situation of the region is that the region's expenditures are poorly secured by local tax potential. Social and infrastructure expenditures grew disproportionately. The situation required more support from the federal center.

The economic situation of the Republic of Altai can be changed without federal aid by diversifying the production structure, promoting the development of small businesses, improving local investment climate and searching for new markets.

Creation of favorable business medium with a view to attract external finances, including other CIS countries and regions of Russia, can be one of the perspective trends in the Republic of Altai. First and foremost, it is essential to identify objects of investment, which would be able to pay off the investments at the shortest possible period.

One of the perspective trends for implementation of the region's development strategy is to intensively involve natural resources into the economy. Forestry, range utilization and mineral resources production have a great impact on the economy and environment of the Republic of Altai. Traditional production of antlers and medicinal herbs also require support. Given the growth in the demand for medicinal preparations based on natural extracts, it is appropriate to speed up production of medicinal and technical raw materials and set up enterprises for processing of these materials.

The unique nature and extremely wholesome environmental conditions of the Republic of Altai make it attractive as a tourist and health resort. The development of these trends will bring new jobs in the recreational sector of the economy as well as in the allied industries namely, trading and catering, hotel management, communications and transport.

The above trends of development are promising both for the region and Russia at large. The trends can be implemented not only through investments but also by qualified management at all levels, which is among the primary problems that remain to be resolved in the Republic of Altai.

3. Determination of Priorities of Long-Term Social and Economic Policy of the Republic of Altai

3.1 General Principles of Business Activity and Investment Attraction

At present, many Russian regions are facing typical problems, which impede their development: lack of budgetary funds, decrease in production, low living standards, unemployment and crime. Generally, the phenomena take root in the past: some regions have a very narrow tax basis as there is virtually no production facilities on their territories. Local authorities (head of the region, city and district authorities, legislative authorities) find themselves in a position of having to instantly resolve the current problems (pay of wages to public sector workers, prepare housing and communal services for winter etc). The resources of regional authorities are small enough to allow them to achieve medium and long term objectives. At the same time, the main problems of regional development would defy solution without developing a sound strategy.

Many Russian regions are facing the classical problem of lack of impact that could initiate the development. The situation turns into a vicious circle when local population does not earn enough to make their consumer spending serve as incentive for the development of trade and production. The phenomena were already described by classical authors, such as H. Singer, H. Leibenstein and R. Nurkse. However, they referred to national level rather than regional. Our hypothesis assumes that similar phenomena can be observed at the regional level, especially in a country like Russia, with regional economic potential being fairly unequal. As long as production and trade remain undeveloped, people continue to earn little, and it keeps repeating year after year. There is no way for new jobs and additional earnings to appear. A region needs money to develop, while no money can be earned if no development takes place. How can this vicious circle be broken? The practice shows that the problem can not be solved by the federal center's provisions alone. Funds allocated for pensions, allowances for children, salaries of public sector workers are often spent to purchase goods and services in other regions, where they are produced at a lower price and of better quality.

Actually, it is not only a problem of "where to generate money from for the development of the region". Substantial financial resources, even if it become available, may come and go even without moving the regional economy toward economic and social development. On the other hand, if the regional authorities set up an investment climate favorable for the development of the region and act efficiently and consistently to guarantee fulfillment of the adopted legislative and standard base, such a favorable environment will multiply the outcome even though the investments are small: new jobs will be created and personal incomes will grow. Investment climate includes stable political and social order, predictable tax policy, business freedom and well-regulated infrastructure of the region.

To get things moving, there should be a small but carefully calculated starting impulse, which will swing the pendulum of the business activity. This will make the region attractive for the investors looking for possibilities of secured and profitable investments. We are dealing with a package of measures, which will recover the region from a social and economic stagnation.

The geographical location of the Republic of Altai makes its economic development extremely difficult. The republic is located far away from the center, big cities, transportation routes and potential markets. Transportation infrastructure is absolutely undeveloped, and mountain terrain of the region makes it twice as difficult to resolve this task. There are no

mineral resources in the territory of the republic, nor any large production facilities. Hence the internal resources and prospects of internal savings are extremely small. It is necessary to attract external investments, both from Russia and abroad. Thus the need arises to create an almost ideal investment climate rather than simply good one. Unlike a megalopolis or a region rich in raw materials, the republic, with its geographic location and lack of offers that would be attractive for instant or superprofitable investments, cannot afford a simply good investment climate, let alone a poor one.

At the same time, there is a region in Russia, which faced the same problems, and nevertheless has managed over the ten years of reforms to attain considerable changes in its economic potential precisely by attracting Russian and foreign investments: the Novgorod oblast.

While both the Republic of Altai and Novgorod oblast were in the early nineties in positions that were in many ways similar to each other, they have pursued different investment strategies during the ten years of reforms. Their initial position can be described as follows:

- there were no highly valuable natural resources (gas, oil, gold, aluminum etc.) in the territory;
- there were no large or modern manufacturing facilities in the territory;
- both regions were chiefly focusing on agriculture;
- transportation infrastructure was poorly developed;
- no "transit rent" was charged.

Some differences in the conditions of these regions are significant, though. In the Republic of Altai the percentage of urban population only amounts to 25 percent, while in the Novgorod oblast it is the other way round: about 65 percent of the population live in small and medium-size towns. The Novgorod oblast is located between large potential markets – Moscow and St. Petersburg. The Republic of Altai, however, due to its geographical position and for climate reasons is one of the most attractive places for the development of tourism.

Regarding the investment climate, we first of all mean social and political stability. For the population to see prospects of future prosperity there should be a sensible regional policy that at a certain point in time would result in a radical turn in the views and expectations. To this end it would suffice that the authorities act as a guarantor of order and stability, have a united team in the executive bodies, in legislature and on the municipal level and cooperate constructively with subfederal structures.

The role of the Head of the region must be fundamentally reconsidered. His duties must lie not only in economic and social administration spheres, but in open policy as well. A policy will be successful provided that it will promote and provide opportunities to the economically active population instead of ordering dogmatically what should be done. One of the main tasks of regional authorities is to create favorable conditions for business. When tax and structural policies are balanced, private interests of businessmen will serve for the welfare of the region and create a basis for employment and earnings of other citizens. So, the priorities may be defined as follows:

- Establish a stable social order, which would radically improve the regional investment climate.** Strong and even stringent authority of the Head of the region that remains within the framework of the law shall not contradict civil freedoms and private initiative. Experience shows that for business to develop and the play of the market forces to lead to an increment in revenues and prosperity, there should be somebody who would ensure

that the rules of the game are observed and stop violations of the general and economic law. Even the most progressive legislation would be ineffective if no guarantees of personal immunity and court independence are provided.

□ **Focus on implementation of real obligations of the Head of the region.** Unfortunately, until now many heads of the regions see themselves as “heads of all enterprises” and philanthropists who distribute the funds of the state budget. In the modern world the functions of the regional authority in respect to business include the following areas:

- establish conditions that would favor economic activity, support competition and protect business entities from monopolies;
- establish and maintain clear and efficient legislative base for economic agents;
- protect economic agents from crime;
- ensure predictable tax policy promoting investments in the regional economy;
- organize direct social support of low-income population.

□ **Create a system for administrative support of investments.** An investor must have a clear idea about the conditions of economic activity, legal environment and potential risks in the region. The investor can have reasonable or unreasonable doubts in respect of reliability of the authorities. The task of the regional administration is to demonstrate clear and understandable process of decision-making and ensure quick passage through bureaucratic formalities. The authorities must provide the potential investor with all necessary information regarding the legislative and normative environment of the region, advantages of this region in comparison to other regions and the capacities of the regional infrastructure.

□ **Work out an investment description of the region.** It should present an investment proposal of the region, describing the resources of the region and the most promising opportunities for capital investments in the regional economy with preliminary calculations. Such a description will serve as a basis for an investment proposal of the region. Something has been done in this respect already, namely one investment project is being displayed on the official web- site of the Republic¹, but this is clearly not enough. In the course of the past years the Government of the republic has been actively looking for investors, both from Russia and abroad. However, up to the present time this has been done chiefly through personal contacts of the regional authorities. It is necessary to create an integrated system of *external advertising of the region* that would provide direct contacts with potential investors.

Certainly, a regional policy that creates incentives for independent activity is not limited to the above stated measures: they only permit to see the direction of activities.

3.2. Main Directions of Economy Restructuring of Republic of Altai and Factors Contributing to Viability of Basic Sectors

3.2.1 Tourism

Tourism is a very profitable business today. It can form a basis of budgetary revenues even for entire countries (e.g., Cyprus or Portugal). The modern industry of tourism can have various forms.

¹ www.altai-republic.com

The Altai region is a combination of mountain and flat relieves and various picturesque landscapes. The points of interest in the region include the Kazakh culture museum (ail) located in front of the bridge leading to the lake Aya, an archeological attraction – the site of ancient settlement Souzga, next to the village of Souzga. It would be also of interest to see the Denisova cave, the only historical object in Altai that consists of more than 20 cultural layers. The Shebalino district is rich in historical and archeological sights: the burial grounds Tourak-1 and Big Tolgoyek, the sites Tinkesken-2 and Choba, the burial mounds Ilyinka and Shebalino. The Seminski pass, the highest point of the route to the Chu Hollow (1,894 meters above sea level), enjoys great popularity. The old Altai name of the route is Djal-Menku (the Eternal Mountain). Lake Teletsk is located in the Turachak district. This lake is often compared with the Baikal. Grand cedars forming the so-called Teletsk cedar forests grow along the bank of the lake, right by the water. The unique natural objects of the Republic: the Altai Reserve and the adjoining territory around Mount Belukha, recreation area Ukok and other sites are included in the UNESCO World Heritage List.

There are countless opportunities to develop various forms of tourism here, including:

- a great number of archeological and ethnical sights, such as burial mounds and grounds, ancient settlements and sites, cave sites of the stone era and rock carvings;
- high mountains that present a splendid opportunity for mountain climbing and skiing;
- the rich fauna of the republic that gives opportunities to hunt bears, marals (Siberian deer), elks, foxes, wild boars, wood grouses and other animals and wild fowl;
- medicinal springs with radon waters and medicinal muds;
- food produced chiefly by traditional methods and pure from pollution since the vast territories of the Altai mountains have remained free from industrial development;
- food of natural origin with proven medical qualities, e.g. reindeer antlers obtained at maral farms², honey and propolis from mountain bee-gardens, mumiyo and golden root. Vegetative resources include more than 2 thousand plants, out of them 200 species are endemic and can be found only in the Altai mountains;
- original national culture of Altai people, peculiar Old Believer colonies, followers of Roerich etc.;
- a rich collection of national souvenirs, woodcrafts and goods made of stone, hides and bones of wild animals.

Setting up the conditions for the development of a tourism and recreation complex would be an effective methods of structurally reorganizing the economy. Successful development of business would create incentives for trade, construction, transport, agriculture and cultural institutions. As a result, additional financial resources (including foreign currency) would be attracted to the economy of the republic, employment would grow and demand for locally manufactured products would be secured. To realize this assignment it is necessary to set up modern tourist hotel complexes with a wide range of services and to construct general tourist complexes.

In the Republic of Altai there are the conditions for the development of the following types of tourism:

² The antlers of the maral reindeer that are used to manufacture pantocrine, a medicine used to treat various conditions and considered a valuable biostimulator for the human organism. The antlers are sawn off a reindeer's head; later on they grow again. A problem exists of biological optimization and humanization of this procedure.

- climatic health resorts,
- extreme sports.

The distinctive feature of **climatic health resort tourism** is that the regional climate and landscape are used to attract tourists. The mountain relief and beautiful lakes can serve as such a feature in the republic.

In any case, this type of tourism implies good climate and favorable ecology. Fairly large initial investments are required to organize such tourism and a fairly long time is necessary to put the entire resort system into operation. A wide advertising campaign should be organized to attract as many potential customers as possible, with all levels of income. In any case, organization of tourist business needs careful market researches.

A chain of hotels and campings of fairly high standards campings have been established in the republic in the recent years. At present several dozens of tourist complexes and recreation sites function in the republic, including tourist bases that operate 365 days a year (e.g., Kivi – Lodge, the Royal Hunting, Edem, Katun, Golden Lake, Yunost and Kucherla) and the training center Semilski Pass. The so-called rural tourism is being developed, with individual wooden houses (or rooms) for guests a picturesque place by the river at foot of a mountain. Such houses are equipped with all necessary facilities, i.e. rooms for two or three persons, well-equipped kitchens and small wooden bathhouses; the local guide (the owner of the house) would provide customized outings and trips.

Still, the issue of the day is to set up new tourist complexes intended not only for middle class but also for demanding clients.

Besides, if the Russian market of tourist services is more or less informed about the advantages of tourism and rest in Altai, promotion of Altai to the international market is at its initial stage.

However, a different kind of tourism, which differs greatly from traditional ones, can turn out to be promising:

- **extreme sports tourism.** This kind of tourism can take up various forms. Unlike the traditional forms where permanent attention and regular efforts by local authorities are required to organize resort complexes, this kind of tourism can spring up independently. Local authorities only need to introduce some order to this process. Independent tourism can do good as well as do harm to the region and its environment. That is why local authorities should interfere not only for financial reasons. As a negative example we can cite the situation which took place at a certain moment in the area of the Sevan Lake. Due to a great number of tourists arriving there on an unorganized basis, the unique species of fish living in these lakes were endangered. Issuance of fishing licenses not only helped to save rare species of fish, but also gave additional money to the local budget.

Different resources can be used to organize zones of sports tourism. Sports tourism can vary from respectable mountain skiing resorts to rafting down mountain rivers, hunting and fishing. It is necessary to work out an interesting concept of the exotic component and invest some resources into the indispensable infrastructure. It can include such entertainment that would allow a modern city-dweller to experience unforgettable sensation and throw off the weight of everyday cares, e.g. mountain climbing, hunting exotic beasts, getting to know the culture of indigenous peoples and original religious beliefs etc. In this respect the Republic of Altai has all necessary conditions: from shamans to the admirers of the works of the Roerich family creative that have their interest in the region.

Organizing exotic and sports tourism consists not so much in some special factors of the nature or large investments as in the ingenuity of local businessmen and administration.

However, this type of tourism has its drawbacks. The main drawback is a small and limited circle of those who fancy a certain type of exotic or sports tourism. Market researches and advertisements promoting the republic as a place where such services are provided must target directly the clubs or certain groups of people that are the main consumers of these services.

Thus, one can talk about two main components of tourism industry development, namely development of the tourist services sector proper and of advertising and creative support.

On the whole, to create a tourist complex operating at international quality standards it is necessary to solve the following tasks of the regional importance:

- develop the material base for tourism by setting up conditions for attraction of investments in reconstructing the old and constructing new hotels of various sizes, tourist bases, camps and the entire infrastructure of the tourism industry. To this end it is required to:
 - define proprietary relationships and solve the issues of providing water and land territories for tourist projects;
- define government guaranties to foreign investors;
 - organize a modern tourist market on the basis of competition, specialization and cooperation in the activity of tourist organizations;
 - organize a modern system of training, retraining and further education of personnel working in tourist business; conduct scientific surveys in the area of tourism;
 - maintain informational activity of regional authorities and private tour operators to inform potential customers of the opportunities and advantages of the region.

3.2.2. Development of Transportation Infrastructure

At present about 90 percent of registered cargo turnover between Siberia and China goes through the cities of Zabaikalsk, Nakhodka and Vladivostok. This is a very long and expensive route. Part of loads is transited through Mongolia and Kazakhstan. It has been reiterated that construction of a direct (short) connection with China would be an important element of the region's development strategy. To realize the opportunity, provided by the 50 km of Russian-Chinese boarder in the south of the republic, it is necessary to construct a branch from the Chu road via the Ukok plateau and the Kanas pass.

A direct motorway to China would reduce the transit routes to 30-50 percent of the current length in comparison with other alternative variants (via Kazakhstan or Mongolia), make a large portion of transportation from West Siberian regions cheaper.

To develop cargo transportation between Mongolia and Western Siberia it necessary to reconstruct the Chu road and build a state-of-the-art customs point in Tashant. Development of transportation infrastructure can attract significant transit rent to the region.

However, the solution of transportation problem would in many ways contradict the task of developing the region as a zone that is favorable for tourism. Besides, this task requires significant investments, which the republic cannot afford at present. Hence, it is clear that the

transportation problem can be solved only in the event that the federal center or big commercial structures are interested. Consequently, we are talking about either a considerable strengthening of lobbyist capacities of the Head of the region (and there is no ground for such strengthening is observed) or improving the investment climate. Only then would it be possible to work out a plan, which would treat the environment of the region with caution.

For agricultural regions, similar to the Republic of Altai, with mountain areas and places difficult to access, it is an urgent problem to provide regular transportation. At the present time access to the capital of the region, the city of Gorno-Altai, is difficult. There is no aviation connection. The nearest airport is in the town of Barnaul; it takes about 4,5 hours to get there by car. The condition of the roads leaves much to be desired. For tourists with relatively low income, who cannot afford traveling by helicopter, access to many places of interest will require long marches on foot, which for some would be not acceptable.

In most of the regions local authorities try to maintain public transportation in governmental or municipal ownership as a resource of "real money". As a result, the transportation workers usually keep the revenues and the transport pool quickly degrades. Meanwhile, some regions where there was no fear of letting the private sector to provide public transportation services (Kaliningrad oblast, some municipalities of the Moscow oblast etc.), and this experience can be defined as clearly positive. In the Republic of Altai, however, such steps would be effective only if there is a sufficient number of passengers. Commercial bus routes are being organized to meet the need of the population for transportation services, to decrease budgetary expenses on public transportation and freely develop the market of transportation services. It is necessary to allow the rendering of commercial transportation services to enterprises, organizations and institutions, regardless of the form of ownership, and to individual businessmen, meeting the requirements for a standard license to perform transportation services issued by a regional department of the Russian Transportation Inspection in compliance with the order and terms of the Russian Federation Law. It is necessary to organize tenders for the right to operate on regional passenger traffic routes. Besides regular taxes, it is possible to charge bus owners for using bus stops and turning sites along the public transport routes. The winner of the tender would receive an exclusive right to operate the public transportation route. In case of applications for a new, undeveloped route, registration of the passenger traffic route will be performed in accordance with a simplified procedure on the basis of a notification.

3.2.3. Investment in Human Resources. Education and Culture.

At present it is obvious that investments into education and culture, and, therefore into human capital, play the key role in development of countries and regions. Civilized, intelligent and educated people would be able to overcome any temporary technological gap and overcome poverty with the help of natural resources. It would be a mistake to believe that if in some region education and culture were historically not developed, then these aspects are not important. Speaking about tourism development, there is no denying that the quality of human potential of a region belongs to important factors affecting a tourist's decision.

It would be advisable to work out a plan together with the municipal bodies (on a voluntary basis) on transition of educational institutions to economic independence. Law of the Republic of Altai (RA) #21-70 of 27 April 2001 "Education in RA" provides a basis for this.

A fairly small region houses a number of educational institutes (Gorno-Altai University for Humanitarian Research, Gorno-Altai State University, Gorno-Altai Teacher Training College and others). At the same time, the number of subjects, technical equipment and

sometimes the quality of teaching level leave much to be desired. For these reasons lots of students move to Barnaul and Novosibirsk. It would be utopian to talk about developing the republic into a scientific center. Nevertheless, the needs of the republic would be met by attracting best Russian universities with an international reputation to educate the inhabitants of the republic, on the basis of technologies of extra-mural education, Internet technologies and training of schoolchildren and teachers of the region to work with computer telecommunications. It would not be dreadfully expensive to organize the training and methodological work for purposes of extra-mural training, concentrate information resources for the need of college and university education and provide remote access to global information resources, raise information culture and computer literacy of teachers and schoolchildren within the frameworks of secondary education and of University professors and students, set up a regional educational computer network and coordinate its activities. It is possible to set up centers of extra-mural education and further training on the basis of Russian libraries. It is completely feasible and necessary to supply educational institutions and libraries with electronic libraries on economy, law and other subjects (with information on CD-ROMs).

The regional administration is quite capable of providing both budgetary and private financing to replenish library stock (within the framework of the program of the Russian Federation Government for the period up to year 2010 an on the basis of different grants and cooperation with the corresponding organizations, such as the Open Society Foundation, Eurasia Foundation, Tacis and others).

It is necessary to implement a strategy of regional education modernization that implies:

- establishment of a trustee board of educational organizations;
- transition to earlier specialization in the programs of school and vocational education;
- redistribution of control powers (in respect of the quality of education and legality of financial operations) from People's Education Committees to self-governing public organizations, such as trustee boards and parental committees;
- replacement of budget financing with contract and investment financing.

Contract financing stipulates that an educational institute has a right to distribute the received funds; conformity with the educational standards of the state are regarded as the criteria of contract fulfillment; the knowledge and skills of students and graduates are verified by means of a system of running and final quality control of education with no regimentation as to the volume and methods of training. Investment financing (education development budgets) is aimed at achieving certain qualitative results (forming and distributing innovation technologies and methods of education, establishment of personal, material and informational infrastructure).

Special attention should be paid to the necessity to start training specialists who speak English and other foreign languages (required, in particular, to develop the infrastructure of foreign tourism) as early as at school.

It is an important task to attract young specialists to work at state institutions. The regional authorities may introduce small but mandatory quotas for competitive employment to the civil service of talented graduates of higher educational institutions

Conclusion: the main areas of development of the regional economy should include the improvement of the regional investment climate and a shift from the attraction of funds to EER Altai, which is in a controversial situation due to the policy of the federal government that aims at liquidating internal offshore zones and that in 2000 forcefully stopped

registration of new EER Altai members, threatening to decrease the amount of subsidies, to the attraction of investor to certain projects in the territory of the Republic of Altai. Such projects could include first of all the development of regional tourism infrastructure, creative and advertising support to the industry of tourism, promotion of products produced in the regions to the Russian and international markets. The projects of production development and transit/ transportation development considered in the region (the projects envisaged in the program of the republican Government, such as construction of small hydroelectric power stations and meat-processing complexes, maral breeding, extraction and exploration of new deposits of gold, silver, copper, wollastonite, production of biological raw materials, processing of wool and down, production of construction materials, modernization of the transportation infrastructure), while being long-term, should not negatively affect the development of the tourism industry that can bring effect in the medium term already. The regional authorities have created a good legal base for the attraction of investments and granting of benefits (and the experts have noted these achievements). However, there is room for further perfection of the legislation: it is necessary to specify various norms in more details, especially those that pertain to the rules of extending state loans and guarantees. It is also important to carry out a complex of measures aimed at targeting social expenses at concrete recipients and optimizing republican social programs. However, in this regard the effective federal law limits the regional authorities. Using external sources to fund the programs of small and medium business development would also make it one of the growth points. A regularly updated Internet portal has been established in the region in the recent years; however, it is necessary to inform the public and businessmen of various projects available in the republic more actively. Organization of distant training and further education can significantly make up for the current lack of skilled personnel.

3.3 Economic Policy of the Republic of Altai and the Novgorod Oblast and Prospective Measures of Economic Policy Improvement.

Two regions under review are examined: the Novgorod oblast, which, on the background of other regions, distinguishes itself owing to its high economic potential, well developed budgetary legislation and tax regime beneficial for the business environment, on the one hand, and the Republic of Altai, which, in comparison with other Russian regions, is poorly developed. At the same time, the successful experience of the Novgorod oblast may be used for further improvement of the tax and budgetary legislation of the Republic of Altai, which has been showing some positive development trends over the past several years.

| Indicator | Measurement Unit | Novgorod oblast, 1994 | Republic of Altai, 1994 | Novgorod oblast, 1999 | Republic of Altai, 1999 | Novgorod oblast, 2000 |
|---|---|-----------------------|-------------------------|-----------------------|-------------------------|-----------------------|
| Industrial output | RUR billion, from 1998: RUR million | 1407 | 58 | 14151 | 244 | 18909 |
| Agricultural output | RUR billion, from 1998: RUR million | 372 | 189 | 3317 | 1197 | 4314 |
| Gross regional product | RUR billion, from 1998: RUR million | 1833,8 | 6024,5 | 9401,8 | 22410,6 | 16409.7 |
| Number of privatized enterprises per year | RUR billion, from 1998: RUR million | 199 | 28 | 26 | None | 49 |
| | | | | | | |
| Investments in fixed assets | RUR billion, from 1998: RUR million | 256,5 | 87,5 | 4061,8 | 248,6 | 5016 |
| Per capita investments in fixed capital | in actual prices, RUR thousand, from 1998: roubles | 345 | 439 | 5587 | 1219 | 6972 |
| Foreign investments | US\$ thousand | 31073 | 45783 | 8062 | 11250 | 94270 |
| Monetary personal incomes | per month, RUR thousand, from 1998: roubles | 170 | 204 | 1337 | 847 | 1689.1 |
| Profit and loss balance | RUR billion, from 1998: RUR million | 243 | -0,0 | 904 | 400 | 2826 |
| Turnover of retail trade | RUR billion, from 1998: RUR million | | | | | 221.8 |
| Payable services to the population | RUR billion, from 1998: RUR million | | | | | 2017 |
| Loans extended to enterprises, | RUR billion, from 1998: | 37,8 | 267,1 | 210,1 | 12,9 | 1408 |

| Indicator | Measurement Unit | Novgorod oblast, 1994 | Republic of Altai, 1994 | Novgorod oblast, 1999 | Republic of Altai, 1999 | Novgorod oblast, 2000 |
|-------------------------------|------------------|-----------------------|-------------------------|-----------------------|-------------------------|-----------------------|
| organizations and individuals | RUR million | | | | | |

Source: Data supplied by the State Committee for Statistics of the RF

Hence, in many indicators of economic development, above all per capita investments in fixed capital in 1994, the Republic of Altai even surpassed the Novgorod oblast. As a result of this it is especially obvious that the Republic has been lagging behind in the past years. Like many other constituent entities of the RF, the Republic of Altai has been trying to solve the problems of economic development by establishing a special regime of favorable taxation for tax agents. However, these experiments have not brought positive effect. The Ecological and Economic Region Altai (EER Altai) was the first free economic zone in the Russian Federation established in 1991. Both for-profit and not-for-profit organizations of any organizational and legal form could become member of the EER Altai. The main purpose of the EER Altai was not to develop or ensure the functioning of new enterprises in the region's territory but to attract the formal domicile of the headquarters so that an enterprise would pay local taxes and duties in the place of its official location. Under Law of the Republic of Altai # 4-14 of 27 May 1998 "On the Improvement of the Legal and Economic Base of Operations of the Ecological and Economic Region Altai" and preceding legal acts of the RF and the Republic of Altai, the status of the zone member was granted to newly established legal entities and branches of legal entities provided that individuals resident in the territory of the Republic of Altai and / or legal entities registered in the territory of the Republic of Altai did not found (participate, invest in) such entities. Under the Law of the Republic of Altai # 4-14 of 27 May 1998 "On the Improvement of the Legal and Economic Base of Operations of the Ecological and Economic Region Altai" the borders of this zone coincide with the administrative borders of the Republic. The main principle of the operation of the beneficial regime lies in full exemption for a five year term from any regional and local taxes, and from the federal taxes (profit tax and the VAT) in respect to the share transferred to the budget of the Republic of Altai, in exchange for payment of a fixed entrance fee and quarterly fees directed at the realization of the programs of ecological and social and economic development of the Republic. The Law does not demand that residents of the EER Altai conduct any business operations in the territory of the Republic (under Article 6 of the Law, in the event that an enterprise engages in any production in the territory of the Republic, the above stated tax benefits remain effective for 10 years, and during the following five years the enterprise pays to the republican budget only 50% of the profit tax, VAT and tax on the property of legal entities. The amount of the quarterly fee is defined in a special agreement concluded between the enterprise and the Directorate of EER Altai, but it cannot be less than US\$ 750. At present the quarterly fee is RUR 4,000 (for enterprises that prepare reports in accordance with the simplified procedure: RUR 800), the entrance fee is RUR 16,000 (ca. US\$ 500). Many enterprises have become members of EER Altai, e.g., a number of V. Bryntsalov's firms that operate in wholesale trade in alcoholic beverages.

Consequently, EER Altai is a model offshore zone in which legal entities are established to obtain tax benefits while business operations are conducted elsewhere. The benefits of the Republic's budgetary system are questionable; first of all because the amounts of tax received from the zone's residents were not directed to the republican budget up to 1999. In accordance with Articles 5 and 13 of the Law " On the Improvement of the Legal and Economic Base of Operations of the Ecological and Economic Region Altai " these taxes are charged to a special account of the zone Directorate and serve as a source of revenues of the Republican Economy

Development Fund whose budget is subject to annual approval by the highest executive body (the State Assembly El Kurultai of the Republic of Altai). In reality, however, the Fund's budget was legally approved only once, in 1998. The funds accumulated in the Republican Economy Development Fund were comparable to the amount of the Republic's own revenues. This gave grounds for tense attitude towards the Directorate of EER Altai and charges of corruption. E.g., according to the above mentioned Decree of the State Assembly El Kurultai of the Republic of Altai of 15 June 1998, the revenues of the Republican Economy Development Fund in 1998 were RUR 35,100 thousand and the plan revenues of own revenues of the republican budget were only RUR 28,250 thousand. In 2000 the Fund's revenues were already RUR 90,321.4 thousand while the plan revenues of the republican budget were RUR 96,650 thousand. The Government of the RF has for a long time tolerated the existence of EER Altai, but, starting from 1998, it began to demand that the Republic cancel the relevant provisions of the local legislation that resulted in benefits in respect of the federal share of taxation, and, first and foremost, in respect of the VAT.

A number of surveys have assessed the activities of EER Altai negatively³. The main conclusions were as follows: Firstly, the benefits of the zone founder are attained for the account of neighboring regions, which are losing their taxpayers. Hence, a region in which a plant is actually located loses the revenues aimed at making up for budgetary expenses relating to business activities in the region's territory (e.g., the costs of maintaining the production infrastructure, roads etc.) Secondly, some of the tax benefits granted by EER Altai result in direct tax losses for the budgetary system as a whole, mainly because the taxes collected from the zone's residents were not charged to republican budget up to 1999. Upon a demand by the Ministry of Finance, which linked the amount of grants to the region with a reduction in tax benefits in the Republic, the tax benefit in respect to VAT for EER Altai members was canceled from 01 October 2000, and the registration of new EER Altai members eligible for these benefits was terminated even earlier. In 2001, in accordance with Article 3 of the Law of the Republic of Altai # 20-33 of 15 February 2001 (as amended at 27 April 2001) "On the Republican Budget of the Republic of Altai for Year 2001", the extra-budgetary development fund of the Republic of Altai was canceled as of 01 January 2001. At the same time, in compliance with Article 7 of the Law, the "Republican Development Fund of the Republic of Altai" was included in the structure of the republican budget, with plan revenues amounting to RUR 79,939 thousand. Although the Budgetary Code of the RF does not prohibit constituent entities of the RF from establishing special purpose budgetary funds, it remains highly questionable whether a region that has a running expenses deficit has a right to subsidize the private sector. In particular, under Section 2, Article 92 of the Budgetary Code, "current expenses of the budget of a constituent entity of the Russian Federation may not exceed the amount of budgetary revenues of the constituent entity of the Russian Federation".

Another norm of the Budgetary Code, namely Section 3, Article 135, determines that "unless the funding of the minimal social standards of the state is provided at a minimum fiscal capacity level, it is not allowed to include in the draft budget the expenses (in the event of budget implementation: not allowed to fund the expenses) not relating to attainment of minimal social standards of the state, or the expenses on the funding of certain social standards of the state above the minimal level in the event that other items of the budget are underfinanced while debt obligations are met unconditionally". However, this norm is not going to become effective until a federal law on the minimal social standards of the state has been passed. And the level of the minimal fiscal capacity ensuring minimal social standards of the state will be calculated primarily on the basis of current expenditure needs (maybe, a

³ E.g., "Budgetary Law and Interbudgetary Process in the Perm Oblast and the Republic of Altai", IET, 1999.

certain amount of funds ought to be provided as a percentage of the budget of current capital expenditure). Thus, it is expected that, once the federal law on minimal social standards of the state is effective, the Republic of Altai will lose the right to spend such significant amounts on investments. Finally, starting with 01 January 2001 already, the subsidized constituent entities have been prohibited from granting budgetary loans and state guarantees in the amounts exceeding 3 and 5 percent of the budget expenses of the constituent entity (Section 2, Article 134 of the Budgetary Code), respectively. At present member companies of EER Altai are exempted from the tax on property of the enterprises, sales tax, special purpose duties on the individuals on the maintenance of the police and municipal improvements, tax on advertising, tax on resale of automobiles, industrial and personal computers, a number of royalties etc. and pay the uniform imputed tax at a reduced rate.

There is no uniform legislative or normative act on the basis of granting tax benefits in the Republic of Altai. On the one hand, the status of member enterprises of EER Altai is clear enough: it is regulated in accordance with the Law of the Republic of Altai # 19-31 of 15 December 2000 "On Taxation of the Member Companies of EER Altai". In accordance with this Law the enterprises are exempted from the tax on profits of enterprises and organizations due to the republican budget of the Republic of Altai and the tax on property of enterprises in respect to the share charged to the republican budget of the Republic of Altai, tax on owners of automobiles). On the other hand, the status of the enterprises, which are located in the Republic of Altai, is regulated by a long list of legislative and normative acts.

The following documents may serve as models for such legislative situation: e.g., Article 31 of the Law of the Republic of Altai (# 23-11 of 26 June 2001) "On State Support to Small Business in the Republic of Altai" says that tax benefits may be granted to "... Organizations providing information, industrial, technical and educational support to the subjects of small business ... according to the procedure established in the effective legislation" without specifying who, on what grounds and for what purposes is supposed to grant such benefits. The Law "On Scientific Activities and Scientific and Technical Policy" (# 5-4 of 14 July 1998) grants benefits to "scientific foundations" (Art.6, Section 3), i.e. not-for-profit organizations funding scientific and research projects on the basis of a decision by the State Assembly of the RA, without any clear criteria. The republic even has laws that specify the procedure of granting tax benefits rather clearly, but only in a certain area, e.g. the Law "On Education in the RA" (# 21-70 of 27 April 2001). For instance, Article 29 of the Law envisages that the State Assembly of the RA exempts educational institutions tax on profits assigned for the activities defined in the foundation documents; introduces tax benefits for the enterprises, organizations and institutions irrespective of their organizational and legal form if they earmark funds for the development of the educational system in the Republic; exempts from partial taxes to the republican budget the owners renting out their property to educational institutions free of charge. The Law of the RA "On Granting Tax Benefits to the System of Execution of Criminal Punishments" (# 15-69 of 29 January 2000).

It is of interest to look at the Law of the RA "On Investments and Investment Activities in the Territory of the Republic of Altai" (# 20-60, passed on 15 February 2001). Article 10 of the Law envisages that in the event of attracting investments in the amount of at least 10,000 minimal wages an enterprises is exempted from profit taxes and property taxes directed to the republican budget of the RA in accordance with the following schedule: (a) during the first three years from the day the benefit is granted: 100% exemption; (b) during year 4: 50% exemption; (c) during year 5: 25% exemption. The law provides for the grandfather clause: Article 14 guarantees stability for an investor carrying out an investment project, the terms and regime defined in the republican normative acts unless such acts are brought in compliance with the federal laws.

The Law contains certain guarantees, which provide that it will not be used for the exclusive purpose of profit concealment. Article 10, Section 2 envisages that exemption from taxes applies to the profit relating to investments either in monetary form or in the form of property investments in the capital of companies and is realized in the event of separate profit and loss accounting for the investment project and the principal activity; Article 10, Section 3 envisages that the amount of tax benefits granted under the Law may not exceed the investment amount. However, it is rather odd for a republic that is in a very difficult financial situation to apply to investors the strict measures defined in that very same Article 10, Section 1, namely that this order covers only "newly established legal entities registered in the territory of the RA". This Section, however, is to a certain extent smoothed by Article 6 that allows to assign one's authorities to individuals, legal entities, state and municipal bodies on the basis of a contract.

It is not clear from the Law whether such benefits are granted automatically (as it follows from Article 10) or, as it follows from Article 9, "may be granted" by the State Assembly of the RA. Passages like, e.g., "The State Assembly of the RA, at the proposal of the Head of the Republic of Altai or the Chairman of the Government of the Republic of Altai, shall determine the priority sectors of the economy, individual administrative and territorial formations and individual projects of special importance for the state which shall fall under favorable conditions of investment attraction", are notable for their obscurity. It is questionable that there will be any economic effect from the measures defined in Article 9, such as "financial support in the form of granting state investment loans at a privileged rate for the account of special funds of the Government of the Republic of Altai", "granting of state guarantees and sureties". In the event that such measures have been realized, this will mean that the Republic itself acts as an investor in respect of a company that has only declared its intent to make investments. In respect to granting state guarantees and sureties it is important to note that, in accordance with the provisions of the law relating to tax benefits, the amount of such guarantees and sureties may not exceed the investment amount. While understanding the reasons for passing such legislative norms (that evidently lie in the possibility of co-investments in a project both by a business and the Government of the Republic of Altai), we deem it necessary to note that the wording of the law requires significant correction. On the whole, a reasonable solution would be to integrate all above-mentioned acts in a separate law "On Beneficial Taxation...". In the opinion of the authors it is also important to ensure that the granting of benefits would not depend on political decisions of regional authorities. It is of fundamental importance that a ban on granting individual benefits is included in the law.

In the Novgorod oblast the system of tax benefits and laws fixing them developed in a different manner. In December 1994 the Law of the oblast "On Tax Benefits for Enterprises and Organizations Located in the Territory of the Novgorod Oblast" was adopted, which provides for exemptions from the tax on property of enterprises and organizations and certain other local taxes in respect to the payments to the oblast budget until an investment project has fully paid back. The business plan submitted to the administration should specify the term of payback. Some districts in the city and the oblast grant additional benefits in respect to local taxes to enterprises with foreign investments.

In 1998 the Law "On Investment Activities in the Novgorod Oblast" that defines the general principles of investor operations came into effect. This law is of a rather complex nature. Law of the oblast # 29-03 (as amended on 07 February 2001) "On Investment Activities in the Novgorod oblast" provides for additional guarantees for organizations implementing investment projects. The concept of an investment project is introduced that implies expenses on creation of, increase in and acquisition of long-term noncurrent assets. A long term is understood as a term of one year or more. This is a positive factor; it provides certain special

guarantees of a stable inflow of funds and directs funds to real production. Article 5, Chapter 3 declares that "incentives for investment activities are provided by means of granting tax benefits to investors ... within the amounts assigned to the oblast budget and the local road fund."

Arthur Andersen has developed a formal methodology for the assessment of a business plan in respect to the payback period. The necessity to obtain a positive conclusion of the administration will not allow applying this benefit too often.

An auditor confirming the calculations of the actual term of investment project payback (Par. 5, Art. 6) should be assigned by an independent person.

The Novgorod oblast is noted for an interesting feature, namely: the projects that are regarded as promising are "monitored", which means that they are assisted in overcoming bureaucratic hurdles (the abundance of such obstacles in Russia has been covered in numerous researches) in a manner that is typical of Russia, i.e. "from above", by means of interference of high-rank officials. This helps to overcome the long time required for processing the documentation accompanying an investment project while each iteration term may differ.

Another peculiarity of the Novgorod oblast is that it guarantees preservation for the whole term of payback of the conditions established in the oblast normative acts of the operations of an organization (both Russian and with foreign capital) that were fixed at the beginning of the investment project, irrespective of the project amount.

However, the Novgorod oblast also tried to introduce a kind of internal offshore zones, namely the so-called zones of economic favor. Such zones have been established in the territories of the problem districts of the oblast: the Batetski, Volot, Marevo and Poddorski districts. In these districts commercial entities (except for traders) are exempted from all oblast and local taxes; besides, tax payers received a refund from the budget of the oblast of the profit tax paid to budgets of all levels, the VAT paid to the oblast budget and the payments for utilization of the forests. However, the experience of these zones of economic favor has failed to demonstrate any changes in the trends, which remain depressive now as before.

Furthermore, the Novgorod oblast has introduced the following measures (that are lacking in the Republic of Altai) aimed at establishing a favorable investment climate. The Law "On Non-Deterioration of Legislative Conditions of Entities' Operations Fixed at the Moment the Investment Decision Was Made". A system of guarantees for investors has been formed; to this end a Guarantee Insurance Fund has been established in the budget of the oblast. Moreover, an information base has been created that, at the investor's request, provides a wide selection of free industrial areas with all necessary infrastructure (gas, water, electricity, waste treatment facilities etc.)

A data bank "Free Industrial Areas" has been created for all towns and districts of the oblast. In case an investment project is offered, it would be possible to acquire the fixed assets of insolvent owners for RUR 1, irrespective of their value. In case a promising investment project is being implemented, the entity's debt are written off and the property that is not being used is taken out of the taxation base (the Law "On Preservation").

Potential investors are supplied with information via a specially established Agency. A special businessman's manual has been prepared that contains data on all local and federal organizations, their addresses and contact persons that an investor will encounter in the course of establishing a company, as well as main issues requiring co-ordination and a list of normative acts.

The Altai Republic could also support the infrastructure of small and medium business development and eliminate excessive administrative barriers as follows.

The experience of the Novgorod oblast demonstrates that the most efficient way for a regional administration to support the small and medium business is to establish a fund (agency) for purposes of supporting small and medium business, and the regional administration or one of its structural divisions could become a co-founder of such a fund (agency). The structural division of the administration should better refrain from operating directly as it sharply reduces the possibility of attracting grants from non-governmental organizations and funds, including foreign NGOs. Such a structure could be co-founded by the Federal Fund for Support to Small Business (which operates under Federal Law # 88-FZ "On State Support to Small Business in RF"), local branches of business associations, unions etc. This fund could focus on the following tasks:

- attract funds from NGOs and international structures aimed at the support of the small and medium business (USAid, Tacis, EBRD etc.);
- arrange free legal advice to beginners at business;
- organize legal support to the initial steps of a company's operations (assistance in registration and liquidation, obtaining various licenses for certain types of activities, development and assessment of business plans for businessmen and plans aimed at receiving tax benefits, plans for financial recovery, plans for obtaining bank loan and investments etc. at affordable prices);
- establish and maintain further education courses for businessmen (on accounting, marketing, personnel management, finance management etc.);
- conduct leasing operations with various types of equipment (under the Russian legislation, this scheme is better than a bank loan since it allows to charge interest payments to costs, besides, it allows to avoid the tax on property);
- establish program of medium-term privilege loans to small and medium businesses (for a term of up to 1.5 years);
- establish programs of short-term privilege loans to small and medium businesses (for a term of up to 6 months).

The privilege lending programs could apply to such operations as acquisition of machinery and equipment, purchase of raw materials, construction and renovation of real estate for production purposes or service operations and to satisfy the need for working capital.

Taking into account that there are practically no large companies in the region, it would be reasonable to extend such credit lines to private businesses with number of employees under 50. The criteria for granting a loan could be as follows: economic efficiency of a project; financial status of the borrower (either no losses or insignificant losses); good credit record; co-financing of the project by the applicant (the advisable minimum level is 25%); a guarantee of repayment (in the form of a pledge (real estate, equipment, automobiles) or a guarantee issued by at least three persons).

Repayment terms could be as follows: monthly repayment of the interest and principal in accordance with the contract; possibility to extend the principal repayment term for up to six months on condition of monthly interest payments; possibility of early repayment at any time.

An extremely important area that requires the forces of the private business is the creation of a system of sales, and, possibly, of processing of wild berries and plants.

The Government of the RF has attained good (albeit slow) results in the area of deregulation of business activities. This includes mainly simplification of entity registration, a significant

reduction in the types of licensed activities and establishing order in the area of verification checkouts of businessmen. However, it is worth noting that the latter measure that is especially important for businessmen (establishing good order in the area of verification checkouts) has been introduced in a half-and-half manner: e.g., it does not include tax and licensing bodies, special services etc. The Federal Law "On Militia" is still effective which allows any militia officer to control at his / her discretion any company for compliance with any norms and seal up the property and the cash desk for an unlimited period of time.

Thus one faces the challenge of establishing a more favorable investment climate without conflicting with the federal legislation. A solution to this problem other than by means of informal arrangements between the branches of authority (which is beyond the competence of this survey) may be found in regulating the obligations of the republican budget, other obligations of the republican and municipal authorities in respect to control bodies and their employees.

A privileged lending program

Besides further steps aimed at establishing good order in the area of verification checkouts (the purpose being of conducting such checks not more than once a year; ideally, such checkouts should be performed by complex monitoring teams comprised of representatives of different controlling bodies so as to save the time of the company that is being checked), other important problems include significant difficulties in the area certifying the goods produced or sold by a company.

To solve this problem it is proposed that controlling bodies, of their own free will, assume an obligation to conduct verification checkouts by any control echelons not more than once a year (with the exception of special services). Another proposed way out could be forming certification panels from representatives of different departments coordinating project documentation (that would confirm that the project documentation complies with the mandatory requirements of the normative documents). An investor could turn to such a panel instead of collecting numerous statements and signatures on one's own. Such panels could proceed from the following rules:

- the mandatory requirements to a project must be published in accordance with the procedure established by law. Unpublished documents cannot serve as a reason for rejecting verification of the project documentation;
- any contradictions in the requirements to the project documentation (including technical impossibility to fulfill the requirements of different technical regulations at the same time) should be interpreted in the applicant's favor and cannot serve as a reason for rejection;
- a consent to verify project documentation compliance with the requirements cannot be unreasonably withheld; the respective explanation must contain reference to the provisions of a normative act that are not complied with;
- the fee for the verification of project documentation shall be determined on the basis of negotiations between an investor and the organization. The verification fee shall include the fee for conducting verification operations and verification monitoring;
- for projects with the value less than 200,000 minimal wages the contractual fee for project documentation verification cannot exceed one percent of the investment value of the project;
- for projects with the value more than 200,000 minimal wages the contractual fee for project documentation verification cannot exceed three percent of the investment value of the project;

Speaking of the budget legislation it is important to note that there is no law on budget process in the Republic of Altai. Annually adopted laws on the budget are practically the only source of budgetary law here. In 2001, though, a law on the order of introduction, consideration and adoption of the Law of the Republic of Altai "On the Republican Budget of the Republic of Altai for Year 2002" was passed. From the viewpoint of its functional purpose this law is close to similar laws adopted in constituent entities of the Federation with well-developed budgetary legislation. In the Republic of Altai such a law has been adopted for the first time; it covers only the current fiscal year and is linked to the Law " On the Republican Budget of the Republic of Altai for Year 2002".

However, a highly developed budgetary law can be hardly expected from a region as notable for a critical level of dependence on subsidies as the Republic of Altai. Under the law on the budget for year 2001, own revenues of the budget were 24.77% (RUR 495.293 thousand) of the total amount of republican budgetary revenues. The total amount of financial aid from the federal budget was 69,45% (RUR 1,388,346 thousand), while the grants of EER Altai member companies make up only 1.76% (RUR 35.209 thousand which seems extremely little considering the amount of tax benefits granted) of budgetary revenues.

The budget has been passed with a deficit of 8.7%. The fact that there can be constituent entities of the Federation with such a low level of minimal fiscal capacity testifies to enormous problems in the federal budgetary legislation; on this background criticizing regional legislation looks somewhat out of place. In such an environment not legislative measures at the regional level will allow to overcome the budgetary crisis in the Republic completely, but this does not mean such measures should be abandoned. Meanwhile, on analyzing the republican legislation one arrives at a conclusion that the regional authorities display little initiative in improving their own budgetary system.

Article 48 of the same law prescribes institutions of local governing to earmark at least 40% of own revenues of the local budgets for wages and charges thereon. This clause contradicts the principle of budgetary independence stipulated in Article 4 of the effective Law "On the Fundamentals of Budgetary Rights and the Rights to Form and Utilize Extra-Budgetary Funds of the Representative and Executive Bodies of State Authority of Republics Forming Part of the Russian Federation, of an Autonomous Oblast, Autonomous Okrugs, Krays, Oblasts, the Cities of Moscow and St. Petersburg and Local Self-Governing Bodies" and in Article 31 of the Budgetary Code.

In making decisions on state support of certain economic projects that are important for the region it would be necessary to establish a clear hierarchy of criteria that can be used to select the most efficient projects. On the other hand, the 2001 budget stipulates an odd order of things, e.g. Article 42 allows "the Government of the Republic of Altai, on a competitive basis, to borrow funds and issue guarantees and sureties for obligations of third parties for the amount of RUR 90,000.0 thousand, including RUR 45,000.0 thousand from the Savings Bank of Russia". No criteria have been adduced that could substantiate the granting of state guarantees.

A region in serious financial strait may be tempted to solve the problem by means of one or two projects that allegedly would bring enormous profits. In reality, however, such "projects of the century" usually - at best - end nowhere, and, if the worst comes to the worst, result in embezzlement of public funds. A notorious example of it is the improper utilization of a loan worth US\$ 1 million granted by the Sakha-Yakutia Republic to the Government of the

Republic of Altai in 1993 - 1994⁴. On the other hand, we have mentioned above that it is necessary to look for growth points. Let us return to the criteria of granting state funding.

Under the law on the republican budget for 2001, in deciding whether to grant state guarantees (loans, compensation) the following criteria should be used to estimate the social and commercial importance of an investment project: "assistance in overcoming the crisis and developing production" (in our opinion, this could be interpreted in multiple ways), "solution of social problems on the republican scale" (an abstract wording, but has a certain sense), "growth in productive capacities in the area of raw material processing" (this criterion is quite useful), "observation of environmental safety of the population" (really a priority). All in all, there are too many such criteria.

In deciding on the social and commercial importance of an investment project it is also taken into account whether the project has been included in approved federal and regional programs.

Thus, we come to a conclusion that the grounds for granting guarantees must be defined as concretely as possible. Furthermore, it is necessary to reduce the criteria list and, if possible, leave only one of them.

Public importance of and public profit from an investment project in which public funds are invested or the liabilities of which are secured by guarantees of the budget should manifest itself in creating new or improving the efficiency of the existing utilities and other public services granted to the population, in the region's economic growth and improvement of the environmental situation. Improving the efficiency of the existing services means reducing service costs, improving service quality, ensuring the services are continuous and expanding access to these services.

The main criteria and conditions on which the regional administration may invest borrowed funds in and issue guarantees of the budget for an investment project should be as follows:

- minimal risk of investment;
- possibility to recover the loan upon project realization.

Budgetary funds may not be assigned or guarantees of the budget granted to investment projects implemented outside the territory of the region or to cover current expenditure of a company. Budgetary funds should be assigned or guarantees of the budget granted on a competitive basis.

All projects submitted for consideration should include a feasibility study that takes into account the terms and conditions of the loan, budgetary efficiency of the project and an estimate of its public importance and profit.

The company implementing the project should, on its part, allow for a counter-payment (pledge) for the issuance of guarantees of the budget. The pledge should be assessed by independent experts or specialists of the regional administration with the account of the need to cover all the expenses in the event that this budgetary guarantee will have to be executed.

In our opinion, the administration may attract funds or issue guarantees to develop the following *priority activities*: sales of local produce outside the Republic, construction and renovation of local roads, bridges and other transportation facilities; the means of local public and cargo transportation; refuse removal and processing; clinics and prophylactic institutions; environmental protection; development of infrastructure for tourism.

Let us compare the Republic of Altai and the Novgorod oblast. In the Novgorod oblast the expenditure of the oblast budget for 2001 was RUR 1,844,501 thousand distributed as

⁴ S. Zubakin, "Robbery, Gorno-Altaysk Style" Barnaul, 1995. The Government declared then that 15 (!) jobs were created as a result of loan utilization.

follows: the projected amount of own and allocated revenues: RUR 839,162 thousand (45.49 percent), grants from the Federal Fund for Financial Support to Entities of the RF: RUR 311,742 thousand; subsidies and subventions from the Compensation Fund: RUR 152,968 thousand; grants for compensation of losses due to changes in the amount and order of formation of the Compensation Fund: RUR 31,552 thousand (total borrowed funds: RUR 496,262 thousand or 26.9 percent); funds allocated to budgets of other levels for purposes of implementing public programs: RUR 7,800 thousand; special purpose budgetary funds: RUR 410,810 thousand. The maximum amount of deficit: RUR 90,467 thousand or 4.8 percent.

Law of the Novgorod oblast # 659-OD "On Budget process in the Novgorod Oblast" may serve as a good model for Altai. The positive aspect, as compared to many regions, is that the Duma of the oblast approves the oblast budget and report on its implementation and subsequently controls budget implementation (in the Republic of Altai the law on budget approval was adopted only in year 2000), and, especially important, the Duma carries out the responsibilities in respect to the federal extrabudgetary funds of the region.

However, the legislation of the Novgorod oblast has its drawbacks, too. E.g., it is not allowed to grant financial aid to the budgets of cities and districts in the form of subsidies and subventions for individual targeted expenses. The law on the oblast budget does not specify the items of targeted expenses, nor does it set limits. Control functions of the Novgorod oblast are described in full in Article 45 of the Law, in particular, the Article envisages that the Duma of the oblast establishes its own control bodies; however, so far this has not happened.

Introducing amendments to the regional tender legislation could become an important aspect of improving the situation in the regional legal environment. E.g., on the whole the relatively newly adopted Law "On Republican State Order" (# 15-34 of 05 January 2000; adopted by the State Assembly El Kurultai of the Republic of Altai on 27 January 2000; amended on 15 February 2001 with # 20-71) looks positive, even in comparison to the laws of the Novgorod oblast: in the Novgorod oblast the requirements to tender supplies are distributed over various legal and normative acts and no details on tender holding are specified.

In the Republic of Altai an open tender has been defined as the most preferred form of supplies (p. 10). It is allowed to purchase goods and services for public needs in a closed bidding in case the amount of purchases is less than 2,500 minimal wages or "the time and expenses necessary to consider and estimate a large number of applications are incommensurate to the value of the products purchased", or when technically sophisticated products are acquired, or products for defense purposes that are related to a state secret (p. 11). In our opinion, the passage on "the time and expenses" should be taken out because the numerically defined (in minimal wages) amount of a deal in itself equals "the time and expenses".

The necessity to hold a closed bidding in case of purchasing "technically sophisticated products" looks also questionable, in spite of the fact that this article copies the respective federal law. If it is required that a product is "technically sophisticated", this clause already imposes a constraint on offer and we do not see any need to make this a closed bidding. A right to make purchases for republican needs by simple methods (the method of requests for price quotation and of purchases from a single supplier) is envisaged for the following cases: in case of emergency, or in case only one bid was submitted to the previous tender, or in case the value of the acquisition is less than 2,500 minimal wages (Article 12).

Previously the law contained a provision on a priority of enterprises domiciled in the republic, but only in case they engage in production and are not middlemen (Article 6). However, experience has demonstrated that this article is not effective enough, and it has been canceled.

Interestingly, this law also regulates supplies for municipal needs (Art. 7). The fact that municipal purchases can be regulated at the regional level is questionable, and the text of the

law confirms it. The reference to the provisions approved by representatives of municipal authorities made in the text of the article seems superfluous.

The procedure has been defined in the law and it is rather difficult to make any positive additions thereto, while a possibility of making negative additions remains (e.g., introducing new non-formalized criteria). Article 7 envisages that the Government annually presents an open report to the parliament on the expenditure of funds of the regional budget on acquisitions for public purposes.

The following factors may be placed among the drawbacks of the law. Like Federal Law # 97 of 06 May 1999 "On Tenders for Placement of Orders on Execution of Works, Supply of Goods, Rendering of Services for Public Needs", the law of RA requires that the criteria for determining the winner should be specified in the announcement about of the tender. At the same time the law fails to regulate these criteria in any way. Therefore, there exists a possibility to establish arbitrary criteria which, in its turn, will result in a formally legal, but completely arbitrary selection of the winner. It seems expedient that the main criteria be established in the law: the minimal price for a good (service) clearly specified in respect to quality and quantity, or the maximum amount of goods (term of service, scope of work) with a clearly specified good (service). Besides, it would be expedient to supplement Article 10 of the law of RA with an article worded as follows: "It is allowed to use a single criterion for winner selection. It is obligatory that the criterion is quantitative. Any qualitative criteria must be formally defined, measurable in accordance with the standard procedures and included in the specification for the purchased good (service)".

The economic sense of Article 18 of the law of RA is also not quite clear: "For purposes of creating economic incentives for commodity suppliers they may be granted, in accordance with the effective legislation: tax benefits; target grants and subsidies; privileged loans; assignments from the budget of the Republic of Altai necessary to ensure growth in the volume of production and supplies". Usually, supplies of goods (services) for public needs is deemed to be bringing profits owing to a possibility of wholesale, state guarantees of contract fulfillment etc. The wording of the law, on the contrary, implies that supplies for public needs are a heavy burden that makes one worthy of compensation from the budget, and what is more, this compensation is distributed on an arbitrary basis determined either by the Government or the State Assembly of the Republic of Altai. The attempt to link the two issues - minimizing state expenditure on purchases and supporting commodity producers (and it does not follow from the law that the producers should be domiciled in the Republic) - results in confusion and creates a basis for corruption. In our opinion, allocation of tax benefits must be described in a separate law and should not be linked to commodity supplies for public needs.

To reduce the expenses of potential bidders it is necessary to provide in the law for obligatory publication of notices on such bidding at the official web-site of the Government of the Republic of Altai.

The differences between the legislation of the two republics can be described with the help of the following table:

| Republic of Altai | Novgorod oblast |
|---|--------------------------|
| There is no uniform bill on granting tax benefits. In reality, there are two regimes: for EER Altai members and for everybody else. | There is a uniform bill. |

| | |
|--|---|
| Up to 2000 EER Altai members were exempted from all local taxes and regional taxes, including the VAT, for a term of five years. This benefit has been canceled starting from 2000. | |
| A one-time entrance fee and quarterly fees to the budget of EER Altai are paid instead. | |
| It is not required to conduct operations in the territory of the republic. | It is required to conduct operations in the territory of the oblast. |
| Non-members of EER Altai are also granted benefits, namely: exempted from profit tax and tax on property for three years; during the fourth year: 50 percent exemption. | Exempted from property tax and local taxes until the project has paid back. |
| Tax benefits are granted by the Government and the parliament of the Republic, the co-ordination procedure has not been formalized, in case the investment amount is less than 10,000 minimal wages. | Tax benefits are granted by decision of the Governor subject to compliance with a formalized procedure of business-plan estimation. |
| EER Altai members are newly established legal entities and branches of legal entities on the following condition: individuals resident in territory of the Republic of Altai and / or legal entities domiciled in the territory of the Republic of Altai cannot be their founders (members, investors) | No criteria are applied to the origin of a legal entity. |
| There is a grandfather clause; however, it covers only non-members of EER Altai. | There is a grandfather clause. |
| There is no law on the budget process. | There is a law on the budget process. |
| There is no agency for small business support. | There is an agency for small business support. |
| There is a uniform legal act on tenders. | There is no uniform legal act on tenders. |
| One business-project for potential investors is represented on the web-site of the republican | 28 business-projects for potential investors are represented on the web-site of the republican |

| | |
|-----------------|----------------|
| administration. | administration |
|-----------------|----------------|

To sum up, one may note that the fundamental distinction between the economic policy of the Republic of Altai and the Novgorod oblast is as follows. The Republic of Altai has put on creating an off-shore zone hoping to attract considerable funds due to the scope of benefits granted, chiefly exemptions from the VAT and profit tax. It was assumed that these funds, accumulated with the Directorate of the EER Altai in a special purpose account, would be spent on developing regional infrastructure. This has not happened, though. EER Altai has excelled not in the quantity and quality of investment projects, but in the quantity and quality of scandals relating to it. This again confirms the well-known argument that state investments are not effective. And when the regional administration started to establish relative order in the operations of EER Altai, the development of the Russian budgetary law minimized the possibilities of establishing and operating offshore zones.

The Novgorod oblast has been developing in the positive direction. Considering the distinctive characteristics of the territory, the chief areas of economic policy include granting tax benefits only to companies implementing investment projects in the territory of the region and auditing such projects; establishing and developing new small and medium businesses, creating very favorable environment for investments in the real sector of the economy with the aim of attaining success at the end; monitoring promising projects on the part of the administration; availability of a portfolio of investment projects for prospective investors. By the time reforms in the Russian tax system reduced the possibilities of granting financial benefits, there were already real companies that were operating, owned equipment and paid salaries to personnel, deducted taxes to the budget; by that time these companies had accumulated a positive experience of cooperation with the Novgorod administration that, on its part, had been pursuing a stable policy for ten years. The importance of this last factor will be discussed in the next chapter.

3.4. Political Development Experience of the Republic of Altai and the Novgorod Oblast.

A region's political development is one of the important factors either affecting or preventing its economic development. The importance of political stability has been repeatedly pointed out. Still, political stability may in reality mean stagnation and fixation of negative trends. Hence, this issue should be regarded comprehensively; in particular, the notion of political stability requires more accurate definition. In this chapter we will compare the examples of the political development of the Republic of Altai and the Novgorod oblast to show the impact this factor has on the development of the economic situation. The first most important difference of Altai is its status of a constituent republic of the RF. The distinctive feature of the development of the republics that constitute the RF does not lie in an own national flag or a possibility to introduce a second state language but in the special mode of functioning of the bodies of state authority and a significantly greater scope of independence from the federal center as opposed to the status of an oblast (kray, autonomous okrug). In accordance with the decisions of the Congress of People's Deputies of the RF, following the revolution of August 1991, the President of the RF received the right to appoint the regional head (governor) in the respective oblasts (krays, autonomous okrugs) for the period of transition (till the end of 1992). In 1993, in an environment of growing conflict between the federal legislative and executive authorities only a few regions managed to hold the elections of the head of the region. The constitutional crisis that became evident after the 1993 April referendum stopped this process, and the adoption of a new Constitution of Russian at the referendum in December 1993 resulted in suspending a number of legal acts used as a basis for holding such elections. A new election cycle began only at the end of 1995 upon adoption of the Law "On General Principles of Organization of Legislative (Representative) and Executive Bodies of State Authority in Constituent Entities". National elections of the heads of regions took place in many national republic as early as 1991; in other republics there was a parliamentary form of government under which the head of an executive body was appointed by a representative body of the respective constituent entity. Neither the developments of 1991, nor the constitutional crisis of 1993 brought any changes to the situation. Consequently, the republics were not governed by a functionary appointed by the President of the RF; it was the population who elected the government, directly or indirectly⁵.

Another distinctive feature relates to a significant number of indigenous population in many republics that sometimes is even more numerous than the Russian population. This does not apply to all of the republics, though. There are republics where the Russian population is in overwhelming majority as compared to the indigenous population. The Republic of Altai lies in the middle in this respect: according to the 1989 census, the national composition of the republican population was as follows: Russians: 60 percent; Altai: 31 percent; Kazakhs: 6 percent. At the same time, the Novgorod oblast is a model monoethnic region: the Russians make up the main part of the population (94.7 percent).

Since 1997 the highest official in the Republic of Altai is the Head of the Republic of Altai elected in national elections for a four-year term. Until 1997 there was a "parliamentary form of government" in the Republic: the highest official was the Chairman of the State Assembly (El Kurultai); the republican government was also formed by the State Assembly (upon adopting the new Constitution of the RF in 1993 this form of government existed only in very few regions of the RF: Udmurtia, Khakassia and Mordovia. At present it remains only in Dagestan).

⁵ Single exceptions, e.g., the Karachayevo-Cherkes Autonomous Republic, whose Head was appointed by the President of the RF, fail to affect the overall picture significantly.

41 people's deputies are elected to the State Assembly (El Kurultai). The highest executive body of the Republic is the Government of the Republic of Altai headed by the Chairman of the Government of the Republic of Altai. Under the Constitution, the Republic of Altai is in fact a parliamentary republic. Until 2000⁶ the Head of the Republic had to coordinate all designations to the ministerial offices with the State Assembly.

Political stability is an indispensable condition for the creation of a good investment environment. The Republic of Altai, though, could not boast this criterion for a long time. In 1991 the republican administration supported the Soviet Union authorities and was in fierce opposition to the Russian authorities. Like in some other regions, the attempts of the Communist Party nomenclature to fix its status turned into nationalism that is rather funny for a region in which the title nation is in minority. The conservative spirit of the population that had been traditionally voting for representatives of the left-wing forces made things even worse⁷. This used to complicate the life of the regional elite in the past and makes its situation difficult now since the elite requires a constructive dialogue with the federal center to obtain subsidies from the federal budget. The failure of the coup in August 1991 was not followed by any major changes in the position of the republican administration; it participated in numerous combinations of the specific opposition that formed around the Supreme Soviet of the RF. V.I. Chaptynov, like V. Petrov who was then prime-minister, was a member of the Communists of Russia faction in the Supreme Soviet of the RF. Since October 1993 the leaders of the Republic of Altai did not participate in any actions of the opposition any more; on the contrary, they supported pro-government conservative parties (the Party of Russian Unity and Accord in 1993 and Our House Russia in 1995).

Valery Ivanovich Chaptynov was the Chairman of the Executive Committee of this autonomous entity from 1988, the First Secretary of the CPSU and Chairman of the Supreme Soviet of the State Assembly from 1990, Chairman of the State Assembly in 1993 - 1997. In

⁶ In 2000, following a claim by S. Zubakin, the Supreme Court of the RF declared that a number of articles of the Constitution of the Republic of Altai contradicted the Constitution of the RF. Almost all disputed provisions were declared non-complying with the RF Constitution, including, which is important, a provision of the Constitution of the Republic of Altai envisaging mandatory coordination with the parliament of the appointments and dismissals of the heads of executive bodies. Under the decision of the Supreme Court, the Head of Republic may dismiss members of the Government and heads of executive bodies and need not coordinate with the parliament appointment of all ministers, as was the case previously. Furthermore, the provisions of the local Constitution envisaging an early recall of the Head of the Republic have also been declared illegal.

⁷ In 1991 the winner in the region was N. Ryzhkov (32.03 percent), followed by A. Tuleyev (24.36 percent), B. Yeltsin (22.39 percent); V. Zhirinovskiy (10.21 percent) and A. Makashov (3.53 percent). This phenomenon is also typical of the Altai Kray and the Kemerovo oblast.

In 1993 54.22 percent voted for the Constitution of the RF. The list of parties looks as follows: the Party of Russian Unity and Accord (26.55 percent); the Liberal -Democratic Party of Russia (17.04 percent); the Communist party of the Russian Federation (11 percent); the Choice of Russia (9.13 percent) etc.

In 1995: the CPRF (29.95 percent); the LDPR (9.34 percent); "Communists - Labor Russia" (7.64 percent); Women of Russia (5.63 percent); Our House Russia, Democratic Choice of Russia and Yabloko received less than 5 percent of votes.

In the first round of the presidential elections of 1996 21.19 percent of votes were cast for Yeltsin, 47.8 percent for Zyuganov, 10.91 percent for Lebed, 5 percent for Zhirinovskiy, 2.8 percent for Yavlinsky. In the second round 51.68 percent supported Zyuganov, 43.04 percent supported Yeltsin and 3.79 voted against all.

The winner in the parliamentary elections of 1999 was Unity with 27.5 percent of votes, leaving CPRF behind with 25.6 percent. The OVR bloc represented by one of its leaders, M. Lapshin, who was running in a one-mandate constituency, received only 10.3 percent, Zhirinovskiy's bloc received 6 percent, the Union of Rightist Forces (SPS) could hardly get over the barrier with 5.4 percent, and the Yabloko bloc received less than 3.4 percent.

In the 2000 presidential elections the Republic of Altai was one of the few regions where Zyuganov came first with 42.7 percent, V. Putin received 37.9 percent, A. Tuleyev collected a considerable amount of 9.3 percent (this is evidently explained by ethnic motives because A. Tuleyev election campaign in that region was not active), V. Zhirinovskiy got 3 percent and G. Yavlinsky received only 2.6 percent.

1997 the Parliament elected him Head of the Republic. Chaptynov graduated the Altai Institute for Agriculture, worked as an engineer in a sovkhos, then as a party functionary. Chaptynov was a charismatic leader between other managers, especially of the Altai who priding themselves (which is typical of small nations) upon their representative who took a management position in the region. Unfortunately, this resulted in a situation in which the administrative personnel were quite often selected on the ethnical and not the professional basis. Revival of the somewhat forgotten culture and language would take on rather aggressive and absurd forms (e.g., shamanism was encouraged in every possible way - although historically a majority of the Altai are Christians and Buddhists etc.; demands were made for a transition to the Latin alphabet in place of the Russian alphabet that had been historically adopted). The Constitution of the Republic contains a clause stipulating that the positions of the Head of the Republic and the Chairman of the State Assembly are to be taken by people of different nationalities (Article 37, Part 3). The Supreme Court of the Republic of Altai declined to admit that this article conflicted with the Russian Constitution. This article was canceled only in 2001.

In 1997 the regional elite was shocked with unexpected deaths of V. Chaptynov (suddenly died during his business-trip to Moscow on 10 August 1997) and the first vice-prime-minister V. Yalbakov. At present an unanimous opinion has formed as for the respectful attitude towards V. Chaptynov's memory, although in the summer of 1997 the results of his rule were widely criticized.

As a result of the 1997 destabilization of the ruling elite three persons became candidates for the position of the Head of the Republic elected in a national election (Head of the Government of the Republic of Altai): V. Petrov, the former prime-minister; V. Volkov, who succeeded Chaptynov to the position of the Head of Government and Yu. Antaradonov, General Director of EER Altai; all of these persons were identified with the ruling regime. Under the conditions of one-round elections⁸ this fact gave a chance to S.I. Zubakin, a deputy of the State Duma of the RF and member of the right-wing liberal party Democratic Choice of Russia, who was in vehement opposition to the previous administration. The struggle during the election campaign was quite tough. Petrov and Antaradonov were criticized for being involved in machinations, Romashkin, the First Secretary of the CPSU Okrug Committee for being Communist and Russian and Zubakin for his pro-Russian and liberal views.

71.2 percent of voters participated in the elections of 14 December 1997. 22,186 voters (23.5 percent) cast their ballots for Semyon Ivanovich Zubakin, 21,978 (23.28 percent) voted for Y.V. Antaradonov, 17.62 percent were for V.V. Romashkin, 13.84 percent chose V.I. Petrov, 11.47 percent voted for V.V. Volkov, 2.26 percent were for I.A. Chernov (offered by Lebed's party), 0.92 percent voted for B. Ya. Bedyurov and 2.4 percent were against all. Hence, Zubakin won with a minimal advantage, only slightly improving his result of the election to the State Duma in 1995.

S.I. Zubakin is the only one of the candidates with a degree in economics. Zubakin was born in 1952; graduated from the Biysk Technical College for Forestry Engineering, thereafter he graduated the All-Union Extra-Mural Institute for Economics and Finance with a degree in finance and credit. Headed the democratic movement in the Republic of Altai, became deputy Chairman of the Supreme Soviet in 1990 - 1993, became a Deputy of the State Assembly of the Republic of Altai, became an auditor of the Ministry of Finance of the Republic. From 1995 Zubakin was a deputy of the State Duma of the RF.

The Government of the Republic of Altai was formed, on the basis of recommendations of the Head of the Republic of Altai, by the State Assembly that was elected in parallel to the Head

⁸ The election system has been reformed now, and elections are held in two rounds.

of the Republic. Zubakin's followers do not have a majority in the State Assembly, and the Government was formed on a trade-off basis. Apart from advantages such a policy of compromise has serious disadvantages, too: there was no unity in the regional Government, its different members had different economic views and there was no sensible policy in respect of human resources. Moreover, a number of ministers and vice-prime-ministers appointed on the initiative of deputies of the State Assembly were later on dismissed for financial breaches; these scandals affected not only the authority of the Head of Republic, but also the authority of the region itself.

The election of S. Zubakin, a person with reformatory view, has eliminated practically all contradictions with the federal center. Constructive cooperation with the Ministry of Finance of RF has helped to change the ratios for grant calculation dramatically.

However, a number of crises occurred in the political life of the region.

In 1998 an impeachment process was commenced by a group of deputies of the State Assembly. In their "crusade for the truth" these representatives of people charged Zubakin with "failing to live up to the promises of the election program". As a result, for want of any serious grounds (which, in the Russian legal tradition, may be only charges of a grave crime) the impeachment process ended nowhere. However, this could not help affecting the rating of the regional head negatively.

Zubakin's ability to attain mutual understanding with the federal center, and, most important, with the reformer group in the Federal Government, however, had its drawbacks as the political views of the Head of the Republic clearly contradicted the views of the regional political elite and the population in general. S.I. Zubakin, elected by means of an election system that did not require an absolute majority of votes, turned out to stand "too far to the right" for the regional elite that traditionally adhered to left-wing-populist rhetoric. Even more evident was the discrepancy between the electoral sympathies of the population that even in times of sharp drops of the popularity of the communists preferred Zyuganov to Putin, on the one hand, and the fact that the region was headed by a former member of the Democratic Choice of Russia. More than once the bodies of federal subordination refrained from supporting the republican administration. Their excess of political engagement also affected the confidence in the authority. E.g., in 2001 A. Berdnikov, the Minister of the Interior of the Republic of Altai, nominated himself for the position of the Head of the Republic in the coming election. Interestingly, the Head of the Supreme Court of the Republic V. Amurgushev also participated in the election campaign. The election campaign of 2001 was carried out in a tense atmosphere. Besides the effective regional head S. Zubakin and the already mentioned V. Amurgushev and V. Berdnikov (supported by the pro-government party Unity), the following persons ran for the position of the Head of the Republic: M. Lapshin (supported by the A. Surikov, Head of the neighboring Altai Kray), the region's deputy at the State Duma, leader of the projectionist Agrarian Party of Russia; V. Romashkin, the leader of the local Communists; S. Krechetov, deputy General Director of the Coal Producing Corporation Yuzhny Kuzbass⁹ and a former second secretary of the oblast committee of the republican Komsomol; N. Dumnova, deputy of the Gorno-Altai City Council and leader of the local Yabloko branch, and a number of secondary candidates. Like in the previous election, the Altai failed to unite and proposed at least two candidates, V. Amurgushev and V. Petrov. The election was rather "dirty"¹⁰. Another mistake of the republican head was that in the parallel election to the State Assembly he backed a bloc of candidates from

⁹ Member of the Euro-As-Holding empire of I. Makhmudov - A. Abramov.

¹⁰ It even came down to posting forged pornographic materials about the members of S. Zubakin's team.

Ekaterinburg representing a businessman P. Fedulyov that were totally alien to the region¹¹. In spite of investments, they all failed, on top of that giving cause to accuse the Head of the region of "seeking support from aliens". M. Lapshin and S. Zubakin reached the second round, getting 23.5 percent and 15.6 percent, respectively. V. Petrov was the third with 14.5 percent; S. Krechetov (13.6 percent), V. Romashkin (12.3 percent), A. Berdnikov (9.9 percent) and V. Amurgushev (6.13 percent) followed him. Other candidates received statistically insignificant amounts of voices. It is especially important to point to the glaring failure of V. Berdnikov, which once again refutes the opinion (popular with politologists), that, owing to V. Putin's high personal rating, the support of the pro-president Unity party almost guarantees success. Experience demonstrates that personal rating does not belong to the kind of substances that can be assigned to a third person.

The result of the second round was predetermined. Out of those candidates that failed to reach the second round nobody was more or less loyal to the existing leader. Besides, when the Russian M. Lapshin reached the second round, it automatically deprived S. Zubakin of hopes that a majority of the population would support "a Russian against an Altai". In the second round M. Lapshin received over 68 percent of all votes, and the existing Head of the Republic S. Zubakin around 23 percent. As for the election to the State Assembly, a majority of votes were cast for the representatives of the old "Soviet" elite, chiefly Altai. Igor Yaimov, previously a deputy at the State Assembly, became the new Chairman of the Assembly.

Mikhail Lapshin, Russian, was born in 1934 in the village of Setovka, Soviet district, Altai Kray, into a family of a worker of a machine and tractor repair shop; graduated the K.A. Timiryazev Agricultural Academy. In 1958 Zubakin became the chief agronomist of the Stupino District, Moscow oblast; chief agronomist of the sovkhoz Gorodische. Starting from 1961 he was the director of the sovkhoz Zavety Lenina; after the sovkhoz went public Lapshin became the president the Joint-Stock Company Zavety Lenina. On 18 March 1990 Lapshin was elected people's deputy of the RSFSR. On 26 February 1993 Lapshin was elected Chairman of the left-wing Agrarian Party of Russia; on 12 December 1993, elected a deputy of the First State Duma by the party list of the Agrarian Party of Russia. On 31 May 1998 he again was elected a deputy of the State Duma from the Republic of Altai; on 19 December 1999 reelected deputy of the Third State Duma of the RF. In 1998 - 2000 certain changes took place in the APR; a radical group headed by N. Kharitonov left it to join the CPRF. In 1999 the APR joined the mild opposition bloc "Otechestvo - Vsyia Rossia" (Fatherland - All Russia) of Yu. Luzhkov and E. Primakov and adjusted its political views centerwise, giving up its previous demands of total nationalization, price regulation, an actual ban on foodstuff imports etc. In the 2000 presidential election Lapshin rendered direct support to V. Putin. At present Head of the Republic of Altai Mikhail Lapshin has completed the forming of the cabinet. Like before, he made up a team of deputies and ministers mainly from the residents of the Republic. N. Taitakov, a local member of the APR, has been designated First Deputy of the Chairman of the Government, V. Torobkov, a journalist, has been appointed Deputy Chairman for Social Issues; N. Moskalyov, manager of a construction firm, has been appointed Lapshin's deputy and Minister of Industry, Construction and Housing and Communal Services; A. Kulagin has been designated another Lapshin's deputy; V. Kuranakov, a member of the APR, has been appointed Minister of Labor and Social Development; V. Romashkin, the leader of the Communists of the republic, has been appointed Head of the Committee for State Property Management; U. Alpimov, former head of the Gorno-Altai branch of the Savings Bank of Russia, has become the Minister of Finance and G. Chekurashev was promoted from a deputy Minister of Economics to the

¹¹ According to one of the versions, P. Fedulyov's representatives believed that an election in this poor republic was the best way to obtain a place in the Federal Assembly.

ministerial position. Interestingly, practically all of the members of the new Altai administration formerly were Communist Party or Komsomol functionaries.

M. Lapshin's relationship with the legislative body are far from ideal (e.g., one of the candidates nominated by M. Lapshin for the post of a region representative in the Council of the Assembly was rejected); still, the degree of confrontation is much lower than it was previously the case.

S. Zubakin did not attempt to immediately form an opposition to the new Government; instead, he congratulated the winner and moved to a position in the Ministry of Finance in Moscow.

Future will show whether and to what extent M. Lapshin will be able to get over the traditional image of a left-wing populist (which is really useful from the electoral point of view) and begin a fundamental modernization of the regional economy.

Unfortunately, the electoral cycles of the President of the Republic and the State Assembly coincide. As a result, various groups concentrate all their forces on the election of the regional head and, consequently, the deputies of the State Assembly are often elected at random fashion (many of them do not have any experience in the area of legislative or other administrative work). Later on this results in limitations on the powers of the Head of the Republic since there is no domination either in the Parliament or at the level of local authorities.

Once the executive and legislative branches consist of representatives of a single team conducting a coordinated policy, the authorities will be able to function with greater efficiency.

Another important issue raised lately is the potential merger of the Republic of Altai and the Altai Kray into a single constituent entity. Alexander Surikov, the Governor of the Altai Kray, has supported this idea. Even before that this had been suggested by Alexander Nazarchuk, the Speaker of the Kray Council of Deputies. Back in Soviet times the republic did belong to the Altai Kray in the form of a Gorno-Altai autonomous oblast; however, at present the suggestion to join may be explained rather by ambitious projects of the kray authorities: construction of a motorway, a gas pipeline to northwestern China and two hydro-electric power plants at the Katun river.

Such declaration by Alexander Nazarchuk evoke indignation on the part of the administration of the Republic of Altai and ethnic public organizations that regard it almost as an attempt at "an interference in the internal affairs of the Republic".

While the idea of merging the two Altais simply has a ring of the recently popular idea of regional consolidation (but Mikhail Lapshin will not agree to it since he has just occupied the post of the republican head), in terms of economic projects the kray authorities may well be supported by the President's plenipotentiary: while visiting the Altai Kray last July, Leonid Drachevsky actually approved of the plan to construct the Katun hydroelectric power plant.

Merging the two regions in a single constituent entity may be a way out for the Republic stricken with a most difficult budgetary crisis. This, however, will require a reduction in the number of regional administrators. It is for politicians to make the final decision.

An opposite situation may be observed in the political life of the Novgorod oblast. In November 1991 by a Decree of the President Mikhail Prusak, a member of the liberal Interregional Group of Deputies, was appointed Head of the Administration of the Novgorod oblast. He managed within a short period of time to establish constructive relationship with the Soviet of People's Deputies of the oblast, and it was noted that the lawmakers actively participated in the discussions of the way of transition to a market economy. In December 1995 Prusak enlisted the support of 56.49 percent of voters; it is interesting to note that during

his term in office was gaining public support, not losing it. In September 1999 he was elected Governor for a second term; this time, however, he received 91.56 percent of votes. No complaints in respect to a forgery of election results were made. Thus, one could say that the popular support of the charismatic governor that was initially strong and later on grew to unseen for a democracy high was in itself one of the factors that contributed to the reforms. In half of the regions the governors appointed by B. Yeltsin from 1991 till 1995 lost the elections. It is not our task to research this electoral phenomenon; it is sufficient to point it out.

The forming of the administration was completed in 1992. There was no conflict between the representatives of the old Communist Party elite and newcomers. The basis of the administration was formed from specialists that had previously worked in the oblast Executive Committee of Peoples Deputies and oblast CPSU Committee, on the one hand, and democratic leaders supported by representatives in the legislative body, on the other hand.

Later on shifts were made only at the very top: new deputies of the oblast Head were appointed and heads of a number of committees were substituted. V. Trofimov, a colleague of M. Prusak in the liberal Interregional Group of Deputies, was appointed Deputy Head of the Administration (later on promoted to the First Deputy); O. Ochin, the Chairman of the City Council of Novgorod, was invited to take the post of Deputy Head for Social Issues. Most of the administrators at the district level belonging to the old Communist Party elite retained their posts.

The Governor's stable personnel policy had its positive effects later on, too. As a matter of fact, significant changes took place only in late 1997 - early 1998: the first Vice-Governor V. Trofimov, upon arranging the administration's work in respect to investment attraction, went to the private sector; his post was taken by M. Skibar, previously a Vice-Mayor of Novgorod.

On the whole, the relationships between the representative and executive branches of power have been developing in a practically conflict-free manner. (In most of the regions, even if both the governor's post and a majority in the assemblies belonged to the Democratic wing, fierce conflicts did take place). It is also important the influence of political parties, even the largest one of them - the CPRF, is weak in the region. The left-wing opposition lacks charismatic leaders, and even at times when discontent was highest the opposition's candidates (head of the local CPRF branch V. Gaidym or the Secretary for Ideology of the Central Committee of the CPRF N. Bindyugov, constantly lost the election: to the State Assembly in 1993, to the Governor's post in 1995; they even received personally less votes than the party list of the CPRF. Starting from 1996 there has been practically no opposition to the Governor personally. Only the federal authorities and some decisions of the regional authorities were subject to criticism.

The electoral history of the Novgorod oblast differs from that of the whole Russian Federation¹². In the election campaign of 1999 Prusak joined Our House Russia; on the whole (without taking into account that Our House Russia got over the 5 percent barrier in the region) the

¹² Initially, in 1991, the level of support for B. Yeltsin was a little lower here than it was in Russia on the whole (46.65 percent and 57.30 percent, respectively). N.I. Ryzhkov received 21.32 percent (RF: 16.85 percent). At the referendum on 25 April 1993, 59.41 percent of the population of the region supported the President (RF: 58.67 percent) and 52.90 percent approved of the President's policy (RF: 53.04 percent), which is close to all-Russia figures. 61.37 percent of the inhabitants of Novgorod approved the RF Constitution of 1993. In the 1993 election, though, a majority of the inhabitants of Novgorod voted for the populist party of V. Zhirinovsky (29.60 percent as opposed to 22.92 percent in the RF on the whole), while the number of votes cast for other parties was close to the all-Russia figures. In the election of 1995 the situation was also similar to the rest of Russia. The CPRF came first with 18.44 percent (RF: 22.30 percent), the LDPR was the second with 12.41 percent (RF: 11.18 percent) and the Our House Russia bloc backed by the Governor was only the third. The results of the first and second round of presidential elections were similar to the figures for Russia on the whole.

results are quite close to the figures for all Russia, only more distinct: having received 31.55 percent, Unity left the Communists with their 19.5 percent far behind. Thus, in the course of the nineties the population of the Novgorod oblast has moved considerably to the right. In terms of reform implementation this creates a good background for business activities.

The Duma of the Novgorod oblast elected in April 1994 turned out to be absolutely loyal to the Governor. The post of the Chairman of the oblast Duma was committed to A. Boitsev, who has been holding this office from then on. The following Dumas elected in 1997 and 2001 were adequate.

As opposed to the Republic of Altai, M. Prusak has maintained loyal relationship with the management of the so-called structures of federal subordination (Department of the Interior, Federal Security Service, Tax Police, State Committee for Television and Radio, Customs Department, the Representation of the President and, later on, the Federal Inspector in the region). In spite of horizontal personnel rotation typical of such institutions, M. Prusak succeeded in retaining in practically all governmental posts (with the exception of the Federal Security Service) the residents of Novgorod, persons that were loyal to him or, frequently, were old friends of his. In the ten years of reforms the Novgorod oblast has seen virtually no criminal scandals or property redistribution¹³. At the same time, the dependence of the subfederal structures on the Governor allows him to prevent any unfriendly actions on their part. The latest trends have been unfavorable, though¹⁴. Over the past ten years the Governor has established, speaking figuratively, a positive credit record in respect to business. Consequently, the strength of his authority is regarded as good, not as evil.

The Governor of the Novgorod oblast has managed to establish constructive relationship with the Federal Government and the President of the RF. It is important to note that one of the country residences of the RF President - Valdai - is located in the Novgorod oblast; this circumstance created good grounds for contacts with the Head of State. Hence, the fundamental differences are as follows:

| The Republic of Altai | Novgorod oblast |
|---|--|
| Due to constitutional peculiarities of the republic's status, during the initial years of reform the center failed to appoint to the republic a head that would actively support market reforms. On the contrary, there was slow evolution of the regional administration from a position of practically total denial of any reforms; | In 1991 the President of the RF appointed a liberally oriented Governor who, in the course of initial reform years, managed to enlist electoral support by the time of the election; |
| Due to the same peculiarities and national composition there was a clear ethnic tension, especially in the period up to 1998; | No political or ethnic tension; |
| The republican administration was | No corruption scandals; |

¹³ Certainly, some negative occurrences did take place. E.g., L. Dyakonov, Head of Administration of the Malaya Vishera District, was arrested in St. Petersburg on suspicion of taking a bribe; his guilt has not been proved in court, though. In 2000 E. Schulman, a deputy of the oblast Duma and Director of the factory Splav was killed. The investigation is still under way.

¹⁴ The Governor has had a conflict with the Federal Inspector for the region G. Andreyeva

| | |
|---|--|
| shocked by corruption scandals, both in the period of V. Chaptynov's rule and in the period of S. Zubakin's rule. | |
| Four heads changed in the course of ten years (V. Chaptynov, V. Volkov, S. Zubakin, and M. Lapshin). | Only one Governor has headed the region during ten years; changes in his team were also minor. |
| In the period from 1998 to 2001 the conflict between the executive and legislative authorities ran to extremes; attempts were made to impeach the Head of Republic | No conflict with the legislative authority of the region. |
| There was no unanimity between the Head of the region and the subfederal structures, chiefly the Department of the Interior and Prosecutor's Office. | The regional authority cooperated with the structures of federal subordination and the Federal Government |
| The population has constantly adhered to left-wing electoral preferences (in 2000 the region was one out of six where G. Zyuganov left V. Putin behind) which prevents liberal economic policy. Even the right-wing candidate that won the election unexpectedly but later on managed to improve economic indicators loses the next election. | The support for democratic forces that was somewhat lower in comparison to the all-Russian level in early nineties later on increased owing to a positive effect of the reforms. |

Thus, one may observe that an entire complex of various political factors is important for regional development.

Conclusion

One of the most important directions of Russian economy's modernization and conditions of its stable growth is the establishment of proportions between different territories that would be adequate to the market economy, equalization of regional differences in respect to social and ensuring economic development and effective functioning of the all-Russian market.

The heterogeneity of the Russian economic space that has formed historically affects the nature of and trend in the restructuring of the national economy significantly. In the course of market reforms the interregional differences intensified due to a change in the competitive environment and relaxation of the regulating role of the state. Strong differences inevitably resulted in wider areas of depression and poverty, weaker mechanisms of interregional cooperation and greater contradictions. The society regards excessive interregional differences of living standards as a violation of social justice principles which influences the political and economic situation to a great extent.

An analysis of the changes in macroeconomic proportions in the Russian economy has allowed to elicit a number of main factors impacting the nature of and dynamics in the transformation shifts. Understanding the moving forces and general trends of social development has helped to clarify the changes in the role and contribution of individual territories in the GDP and the typology of regions in respect to the acuteness of social, economic and ecological problems. A research of reproduction dynamics and structure has revealed general and specific characteristics of the functioning of the Russian economy in terms of regions.

An analysis of the economy of the Republic of Altai from the viewpoint of general economic development patterns of the Russian economy in transition has allowed to reveal the main problems and determine the promising directions of growth.

The Republic of Altai has constantly belonged to low-developed regions; it is characterized by insufficiently diversified structure of the economy, poorly developed infrastructure and a low level of social sphere development. Low living standard is the main problem of the Republic. The Republic is noted for a high share of poor population as compared to the average Russian proportion. Average per capita figures of the gross regional product, amount of investments in fixed assets, volume of the foreign trade and financial capacity remains far below the average Russian level.

One of the ratios describing the unsatisfactory financial status of the Republic of Altai is the low level of region's own tax potential that is there to support the regional expenditure and the ratio of taxes collected in the territory that are directed to budgetary expenses. Under the existing situation support from the federal center is increased. The state lends significant financial support to the Republic, stimulating the process of self-development by means of utilizing competitive advantages, mainly the natural and Labor resources.

The strategic plan of regional development should define the priorities in and stages of the restructuring of regional economy; it should also define a system of measures and resource capabilities.

One of the promising directions of the strategy of the region's further growth is to involve natural resources in economic turnover. Unique biota and most favorable environmental conditions make the Republic of Altai attractive for tourism and as a health resort. Development of these activities would create new jobs in the recreational sector of the economy and the related areas of trade, public catering, hotel business, telecommunications and transportation.

Maral deer breeding and extraction of mineral resources impact the economy and environment of the Republic seriously. Such traditional activities as production of deer antlers, herb growing and herb picking also require support. Considering changes in the market situation and a growth in demand for drugs on the basis of natural extracts it would be expedient to expand the production of medicinal raw materials and create enterprises for their processing.

The economic situation in the Republic of Altai can be improved on by own strength by improving the local investment climate, creating incentives for small business development and searching for new markets.

The geographic location of the Republic of Altai makes its development extraordinarily difficult. The republic is located extremely far from the center, large cities, trade routes and potential markets. The transportation infrastructure requires a lot of development, and the mountainous terrain makes this task twice as complicated. There are no mineral deposits in the republic's territory, nor any large factories. Hence, the internal resources and prospects of their internal accumulation leave much to be desired. It is necessary to attract foreign investments, both from Russia and from abroad. Consequently it is necessary to create an investment climate that would be close to ideal. Unlike a large city or a region rich in raw materials, the republic (with its geographic location and lack of projects of fast and superprofitable investments) cannot be satisfied with simply good investment climate, to say nothing of the negative investment climate.

Although at the beginning of economic reforms the Republic of Altai was objectively in an unfavorable condition, this is not the only reason of the existing problems. The Republic has missed a lot due to political instability manifested in frequent changes in the authorities, conflicts between branches of authority and between republican and subfederal structures that were typical of the region throughout the nineties.

The Republic of Altai counted on attracting funds by means of the Ecological and Economic Region Altai, a specialized agency under the Government of the Republic. The agency's aim was to attract significant funds owing to the scope of benefits granted, primarily exemptions in respect to the VAT and profit tax. These funds were not related to the regional economy but were deducted as a fee for formal registration of the company's head office in the territory of the region, in return for which the company was exempted from all local taxes. Usually the EER Altai member companies did not operate in its territory. It was assumed that the funds thus accumulated with the Directorate of EER Altai would be directed at developing the regional infrastructure. However, this has never happened. EER Altai has excelled not in the quantity and quality of investment projects, but by the quantity and quality of scandals relating to it. This again confirms the well-known argument that state investments are not effective. And when the regional administration started to establish relative order in the operations of EER Altai, the development of the Russian budgetary law minimized the possibilities of establishing and operating offshore zones. The Republic lacks the law on the budget process and a program of small and business development of its own; the degree of development of the information infrastructure is insufficient.

At the same time, there is a region in Russia that was in similar conditions and has, nonetheless, over the ten years of reforms managed to increase its economic potential significantly by attracting Russian and foreign investments: the Novgorod oblast. Some steps that were taken in that region could prove to be useful for the Republic of Altai, too.

The main directions of the regional institutional policy in the future should include improvement of the investment climate in the region and transition from attracting funds into EER Altai to attracting investments directly in projects in the territory of the Republic of Altai. There is room for improving the republican legislation, in particular, it is necessary to

give concrete expression and detailed description to various norms, especially those relating to the order of granting state loans and licenses. It is also important to take a complex of measures necessary to ensure targeted social expenses and optimize republican social programs; however, in this respect the regional authorities are limited by existing federal legislation. The public and businessmen should be more actively informed about various business-projects available in the Republic. Developing the opportunities for distant education and further education would significantly improve the current situation characterized by lack of personnel, especially in the field of consumer services.

Political stability and predictability of the regional authorities' behavior - if achieved - could play an important role.

Consistent measures aimed at developing an economic environment that would be attractive not only owing to tax benefits but also owing to information openness and social and political stability can gradually resolve the problem of modernizing the region and providing the regional budget with funds.