

**Creating Favorable
Environment for Investors:
An Integrated Approach. The Novgorod
Oblast Experience**

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Part 1.

Creating Favorable Environment for Investors: an Integrated Approach. the Novgorod Oblast Experience

Introduction

The implementation of measures aimed to increase the investment attractiveness of a region is a topic, which has interested economists for a long time. At the same time, there exist problems associated with the limitations set by the national legislation and the existence of the general problems of infrastructure, business culture, political and social stability and related limitations.

Yet in the century before last, J. von Thuenen¹ established the hypothesis that it is possible to determine an optimal location for an enterprise basing on the examination of different factors (first of all, of geographical nature). Later, M. Weber² presented the most complete theory of optimization as concerns the choice of location for enterprises. A. Lesh³ paid attention to the institutional factors of the location of enterprises, for instance, the tax system, the state policy as concerns the promotion of competition and informational transparency of markets for potential investors.

As Russia started its transition to market economy in the early 1990s, there became popular concepts of the development of “free economic zones.” In fact, these zones were viewed as territories, which were granted legal rights to be exempted from many taxes and levies, or where were set special lower rates of taxes. Primarily, maritime regions and cities requested such a status. Their key requirement was the exemption from customs duties on imported goods. However, the Russian government soon realized that the creation of such internal offshore zones not only undermined the revenues of the state budget, but was also unfair as concerns other regions, which failed to successfully lobby for such a regime.

¹ J. von Thuenen. *Izolirovannoye gosudarstvo (Isolated State)*. M. 1926

² See: Schlier “*Promyshlennost Germanii s 1860 g. (German Industry since 1860)*” M. – L. 1926

³ A. Lesh. *Geograficheskoye razmescheniye khozyaystva (Geographical location of the economy)*. M. 1959

Besides, no example of successful economic development of an offshore zone was registered during the time they existed in the post-reform Russia.

Studies related to the investment attractiveness of regions (L. Vardomski⁴, N. Zubarevich⁵, O. Kuznetsova⁶, etc.) were mainly focused on the analysis of objective regularities of regional economic development related to the respective economic and geographical location, natural and climate conditions, state of economy, development of infrastructure, etc. A special attention was also paid to the regional component of the federal tax and budgetary policies, and the tax and budgetary policies pursued by the regional authorities. In this relation, the TACIS project “An analysis of the development trends in Russia’s regions⁷,” the World Bank project “Russian regional finance reform,” the CEPRA project “Typology of Russian regions⁸,” etc. are to be mentioned.

At the same time, not-budgetary components of regional development are also important. Even perfect tax and budgetary policies may fail to facilitate the attraction of investment in case such important prerequisites as social and political stability, guarantees of basic human rights, inviolability of person and property, informational transparency, effort on the part of regional authorities, etc. are lacking. The most interesting key studies dedicated to the role of institutions per se is “The rise and decline of nations” by M. Olson⁹, who explained that economic growth is generated by the conditions facilitating the growth of distributional coalitions and special interest groups, and works of D. North¹⁰. According to a hypothesis presented by V. Mau, K. Yanovski, P. Hobson, et al. in “Political and

⁴ A. Vardomski. *Regionalnye protsessy v kontekste federalizatsii Rossii* (Regional processes in the context of federalization of Russia). M. 2000

⁵ N. Zubarevich, A. Treivish. *Sotsialno – ekonomicheskoye polozheniye regionov* (The socioeconomic situation in the Russian regions) / An annual supplement to “Russia’s Political Almanac.” M. Carnegie Center, publications of 2000 and 2001

⁶ O. Kuznetsova. *Ekonomicheskoye razvitiye regionov: teoreticheskiye i prakticheskiye aspekty gosudarstvennogo regulirovaniya* (Economic development of regions: theoretical and applied aspects of state regulation). M. 2001

⁷ www.iet.ru

⁸ *Typologiya rossiyskikh regionov* (Typology of Russian regions). M. 2002

⁹ Olson M. *Vozvysheniye i upadok narodov. Ekonomicheskiy rost, stagflyatsiya i sotsialny skleroz* (The Rise and Decline of Nations. Economic Growth, Stagflation, and Social Rigidities). Novosibirsk, 1998

¹⁰ North, D. C. *Transactions costs, institutions and economic performance*. San Francisco: ICS Press. 1992

Economic Problems of Russia's Regions,¹¹ the approach suggested by M. Olson and D. North may be used not only for inter-country comparison, but also in order to compare different regions of the same country. The differences may be of special importance in unstable transitional economies (as in Russia). Both in Russia and in other countries, there are often calculated rankings of countries and regions based on the presence / absence of different institutions and quantitative evaluation of the levels of development of institutions. The most well known ranking of countries is the annual ranking presented by the Heritage fund. In Russia, the Ekspert magazine annually publishes the ranking of Russia's regions with regard to their investment attractiveness. There are also certain problems. They are mainly related to the formalization of institutions and discrepancies generated by the use of subjective expert evaluations.

In this relation, the successful experience of the Novgorod oblast attracts special attention.

The Novgorod Oblast is known as a region, which dynamically and successfully attracted investment and sustained economic growth in the second half of the 1990s. At the same time, the way chosen by Novgorod the Great principally differs from the ways chosen by other regions. Novgorod the Great did not attempt to create an internal offshore (many other regions sought to reduce local taxes to zero and substitute them with a non-recurrent, although rather considerable, registration fee), did not try to obtain various tax and customs preferences from the federal government, did not guarantee the repayment of credits granted to enterprises situated in the oblast.

The initial conditions of the region were rather unfavorable. A characteristic feature of the oblast was a rather low investment potential: it was ranked 66th among all subjects of the Russian Federation. This general ranking comprised the region's 77th place in terms of natural resources, 65th place in terms of industrial potential, 63rd place in terms of consumer potential (a narrow regional market). In contradistinction to many other regions, the Novgorod Oblast has no enterprises of the raw materials sector (oil and natural gas extraction, processing of aluminum, etc.) associated with high export revenues. The Novgorod Oblast is rather remote from large megalopolises, which could employ the region's residents and provide a market for the oblast's agricultural produce. The region also lacked modern enterprises producing competitive goods.

¹¹ Politiko – ekonomicheskiye problemy rossiyskikh regionov (Political and Economic Problems of Russia's Regions). M. 2001

The regional administration has focused its effort on the creation of an optimal investment climate, guarantees of fair play rules, exclusion of situations where public officials could racket businesses. The political stability also was a positive factor, since no cases of voluntarism, manipulation of elections, or infringement on civil rights were registered in the region.

The region actively pursued the policy of creation of new (in contradistinction to the modernization of old) enterprises. This policy resulted in higher tax revenues of the regional budget, and, therefore, allowed to meet regional social obligations, implement the structural reform of employment, alleviate the burden of the budgetary support of ineffective enterprises.

Key aspects, inferences, and outcomes of the Novgorod's experience of attraction of foreign investment in the region, as well as recommendations on ways and means aimed at the general enhancement of investment activity and better investment regional policies are presented below. The Pskov oblast neighboring on the Novgorod oblast is analyzed as a comparable region.

The authors express their gratitude to O. V. Kuznetsova and D. V. Nenashev for their valuable advice and specifically note the attitude and informational openness of the Novgorod oblast administration, which has greatly helped the authors to collect the necessary information.

Chapter 1. Investing in Russia: Problems and Prospects.

A most pressing problem the Russia's economy encountered in the last decade is the problem of investment in the real sector of the economy. According to the majority of experts, Russia was a prospective region with considerable potential for a rapid economic growth over the whole period of transition. However, in spite of the significant potential of the Russia's market, the amount of external investment in Russia is considerably below respective indicators of a number of other countries.

Investment requirements of Russia. Taking into account the rates of growth of the Russia's economy in the post-crisis period, the demand for foreign investment will only rise. According to different estimates, the potential capacity of Russia is US \$ 70 to 150 billion for 2 to 3 years as the annual foreign investment requirement is US \$ 40 to 50 billion¹².

The figures registered over the last five years provide no grounds for optimism. The objective reality demonstrates that in case no radical changes occur, the real level of investment in the Russia's economy will be insufficient to generate sustainable economic growth. For the respective data on foreign direct investment, see the Table 1.1¹³.

Table 1.1.

Investment in emerging markets with economies in transition (US \$ billion)

	1996	1997	1998	1999	2000
Latin America	35.8	49.4	49.9	68.6	5.8
South East Asia	45.4	51.9	55.2	54.0	3.6
Emerging markets, Europe	9.8	10.9	12.5	15.6	6.6
Russia	2.5	6.2	2.2	2.9	3.5

¹² Aleksashenko S. A. Rossiyski ryok glazami inostrantsev (The Russian Market in the Eyes of Foreigners) // Kompaniya, 2000. No. 6. pp. 25 - 27

¹³ Kim A. E. Rossiyskaya Strategiya i Makroekonomika (Russia's Strategy and Macroeconomics) // Morgan Stanley Annual Report (Russian Edition). 2001. C. 48-69.

A detailed analysis of the present situation reveals that in terms of investment attractiveness Russia is considerably behind not only industrially developed countries, but also its former Socialist allies. Moreover, the dynamics observed over the last three years demonstrate no improvement of this situation. The problem is apparent – the investment climate in Russia does not answer the expectations and requirements of foreign investors.

Rich natural resources, high level of education, and strong intellectual potential are traditionally included in the list of relative advantages of Russia as compared with other countries and regions in terms of its attractiveness for foreign capital.

As concerns the wealth of natural resources, this fact rises no doubts. All other arguments require a more detailed analysis. At a closer look, the competitiveness of the Russia's labor force turns out considerably exaggerated, what is confirmed by independent sources.

The close examination of Russian enterprises reveals that they are not able to provide a sufficient level of general competitiveness and adequate management. Potential investors have difficulties trying to select investment projects meeting the necessary requirements.

This situation also has a flip side. Foreign investment, as a rule, is accompanied by the arrival of managers representing the interests of foreign investors. These managers considerably improve the corporate and financial culture and introduce the generally accepted rules of civilized business at enterprises. However, exactly the introduction of foreign management at domestic enterprises is seriously hampered.

The specifics of the process of privatization have created additional difficulties in this area: the radical transformation of ownership in Russia has not resulted in the creation of adequate mechanisms of corporate governance and control. The majority of Russian companies and their management do not see the problem of improvement of investment attractiveness as a priority.

Infringement upon investors' rights. The last three to four years saw a very large number of infringements on investors' rights. This phenomenon is especially frequent in companies where controlling interest is owned by a financial and industrial group (FIG). Investors lose the possibility to influence decisions and receive information about key issues of companies' operations, and often are completely forced out of such companies, while FIGs take full control, which allows them, in particular, to dispose of financial and material assets of the companies. In the period from the mid-1998 to the early 2001, more than 70 per cent

of the claims concerning the infringement on shareholders' rights were filed with courts by foreign partners.

The insufficient regulation as concerns the grounds permitting to initiate bankruptcies and the bankruptcy procedures per se are also a serious threat to the rights of investors. At present, a special market of legal firms rendering services with regard to the bankruptcy of more or less solvent companies aimed at the transfer of their property and assets to the interested parties exists in Russia. According to certain unofficial data collected by foreign consulting agencies operating in Russia, 8 out of 10 cases of forced bankruptcy gave rise to such suspicions in year 2000.

The paradox is that efficiently operating enterprises are often involved in the procedures of forced bankruptcy since the competitors have a good opportunity to take control over them, while hopeless enterprises avoid this procedure since there is practically no chance to recover debts in the process of bankruptcy.

Investors seriously suffer in the case company managers fail to present the data about the operations and the financial standing of enterprises as required by the legislation currently in force. In certain cases, even the interference on the part of the Federal Commission for Securities (FCS) fails to make the managers to comply with the stipulations of the legislation currently in force. The public became aware of some cases of outright arbitrariness, where registrars in compliance with orders given by managers just removed unwanted persons from the shareholders' registry.

Yet another reason why it is so easy to initiate the process of bankruptcy, is the Russian practice of evaluation of enterprises' operations, which is far from modern requirements. The financial and economic reports enterprises draw up in accordance with domestic accounting principles are mostly useless, since the data they contain do not allow to make a reliable picture of the real standing of enterprises.

Problems of corporate governance. The culture of corporate governance in this country needs a serious improvement. Russia lacks efficient mechanisms of redistribution of property in favor of effective owners. Changes in the structure of owners and movement of equity capitals are as a rule related to the redistribution of ownership rights from employees to managers without an increase in the share of outside shareholders interested in efficient corporate governance. Affiliated persons have a high share in the ownership structure of many enterprises, what creates additional difficulties for potential outside investors. The rights of minority shareholders are often ignored and infringed upon, while the state regulatory authorities and the legal system are yet unable to protect their rights. Many man-

agers of privatized enterprises still do not realize that their responsibility is first of all to look after the interests of owners, and not to serve other interested persons represented, as may be, by the state, local authorities, or labor collectives.

The factors seriously deteriorating the investment climate, as described above, are mostly of the long term nature. No doubt, Russia needs to improve the business administration practices and the manageability of domestic enterprises. However, the process of improvement requires time and the general change in the mentality of the Russian business, therefore, no soon transformation may be expected. On the other hand, there remain many issues, which should be settled as soon as possible.

Problems of business infrastructure. A most important problem seriously affecting the country's investment climate is the modern infrastructure. At the present level of globalization of economic processes, the availability of a highly developed business infrastructure becomes a condition, which determines the inflow of foreign investment. In order to ensure a qualitative improvement of the business infrastructure in Russia it is necessary to resolve a whole complex of related problems, especially in the banking sector.

It is apparent (especially after the crisis of 1998) that the Russia's banking system is weak. In order to recover its viability and improve the confidence of its potential clients, it is necessary to radically improve the banking legislation, create legislative prerequisites for the expansion of the range of banking services rendered to individuals and legal entities in accordance with international standards and requirements of the modern business.

However, even in the pre-crisis period only a very small number of credit and banking organizations was able to render the necessary complex of services. The efforts the government makes to restore the banking sector of the economy are inadequate to the scope of the task. With the exception of ARCO, the effectiveness of which rises certain doubts, there have been no serious shifts in this area.

The underdeveloped Russia's banking system seriously impedes the inflow of investment in the economy and remains a most serious factor of investment risk. The enterprises in the real sector of the economy encounter enormous problems trying to obtain loans, in spite of the fact that Russian banks dispose of considerable idle capitals. The real cash balances on the accounts commercial banks have with the Central Bank grow faster than the amounts of loans they grant. The payments made via the banking system substantially slow down the transactions and increase their costs thus negatively affecting the profitability of economic operations on the whole. The share of entrepreneurs and managers of enterprises

preferring cash payments is still high, what may be associated not only with tax evasion, but also with more timely and reliable payments.

In the course of the reform of the banking system, a special attention should be paid to the problem of guaranteeing household deposits, tighter control over the current financial and economic standing of credit and financial organizations, inclusion of household savings in the investment process. In order to enhance competition in the credit and financial sectors of the economy, it is possible to allow a larger presence of foreign credit and financial organizations on the Russian market and to ease the restrictions on their work with individuals, while limiting preferences and privileges granted to banking institutions with state participation.

Yet another weak point in the Russia's financial system is the institutions oriented towards long term investment. The investment funds mobilizing resources (primarily of the small individual investors) for investment are also weak and not numerous. Their growth is considerably checked by the absence of adequate legislation (as concerns pension and insurance savings), sufficient number of professional company managers, and a low profitability of managing companies. Non-state pension funds and insurance companies, which are largest institutional investors in developed market economies, in Russia primarily serve the private interests of financial groups, in the framework of which they are created. In Russia, there are practically no legal grounds for professional management of the assets of these funds.

At present, insurance companies in Russia are mainly oriented towards performing the functions of institutions used in various tax evasion schemes, to cash money, etc. Apparently, insurance companies primarily engaged in the performance of such functions are unable to play an important role on the market of investment. At the same time, 95 per cent of investment operations of insurance companies are related to state securities. These circumstances and the lack of guarantees relating to the rights of shareholders determine the weakness of the Russia's stock market.

Evaluation of the Russia's legislation. On the whole, the Russian legislation does not facilitate the inflow of foreign capitals in the country. After the decades of the rule of state ownership, Russia has achieved a considerable progress in the legislative strengthening of the rights of private property. Among other legislative acts ensuring the functioning of market economy, the country approved and enacted the Civil Code, the law on joint stock companies, and a number of other laws answering international standards. However, in spite of all positive trends,

these achievements are clearly insufficient. Besides, the practical implementation of the approved laws is quite unsatisfactory.

An important condition for the inflow of investment in the country is the stability of the legislative base, compliance with legal norms, and stringent law enforcement. Laws may be better or worse, and it is possible to tolerate on condition that they will not constantly change.

Over the years of reform, there was practically recreated the legislative base of a market economy. However, many problems in this area are still unresolved. For instance, the work on the Tax Code has not been completed yet; the new Land Code has not been approved yet. Russia still lacks a law on the registration of legal entities, although this procedure is most prone to corruption. The most acutely is felt the absence of a law stipulating the procedures of possible nationalization and setting reliable guarantees for the owners of property subject to nationalization.

The laws regulating the investment activities are seriously flawed. In the area of law making, a frequent occurrence is the adoption of norms used in other legal systems or states with different level of institutional and cultural development.

Many laws are mismatched, contain mutually exclusive norms, moreover, such norms may be often found in the framework of the same law. An illustrative example is the discrepancies between the stipulations of the key laws in the area of investment: the law "On the investment activities in the RF," "On foreign investment in the RF," "On investment implemented in the form of fixed capital investment," between the tax legislation and the law "On production sharing agreements." These laws, for instance, set different tax rates for the same types of activities and differently define the conditions, under which investors should be protected against unfavorable tax changes during the implementation of their projects. Frequent amendments in the legislative acts currently in force is not well thought out and often amendments aimed at the resolving of short term problems undermine legislative stability. For instance, in order to reorganize ARCO, which was created as a joint stock company, and turn it out in a not-for-profit organization, a stipulation allowing to transform joint stock companies in not-for-profit organization was added to the Civil Code. This amendment has destroyed the existing concept of the RF Civil Code, which clearly discerned commercial and non-commercial organizations where participants were granted principally different rights with regard to participation in the management of respective legal entities, dividends, and property in case of their liquidation.

A destabilizing factor of entrepreneurial activity is also the discrepancy between the federal and regional legislation.

Some very important spheres of business and relations arising on their base are either practically outside the legislation currently in force, or are insufficiently regulated, what results in numerous economic and judicial collisions. First of all, it concerns the problem of the legal regulation of the modern communication systems comprising mobile systems, Internet, interactive mass media, etc. At the same time, this is the most rapidly growing sector of the domestic economy. It is also necessary to ensure an effective mechanism of the legislative regulation of access to, turnover of, and use of commercial information.

In the framework of the general improvement of the investment climate at the legislative level, there should be resolved the problem of proper registration of activities of foreign capital in the Russia's territory, guarantees of inviolability and freedom of export of foreign capital and profits by non-residents from the country. It is impossible to create serious incentives for the inflow of foreign capital in Russia without taking serious steps in this direction.

The institution, on which any economic model of the market type is based, i.e. the institution of private property and specification of ownership rights on the whole, also needs to be modernized in terms of legislative registration. It is also necessary to improve the stipulations of the Civil Code in order to bring them in accordance with the requirements of modern contractual law and create a legislative base for the introduction and effective use of the institution of the private property for land.

In terms of social stability, it is very much important to take measures aimed at the elaboration of legislative mechanisms of registration and functioning of the system of mortgage crediting, fixation and guaranteeing of the results of the industrial privatization. The constant threat of the review of the results of privatization creates an impregnable barrier for potential investors, although, as a rule, the most successful privatized companies evoke the most wide public response. The transition of administrative bodies to a simplified system of registration, control, and oversight with regard to enterprises, a gradual transition to the notification principle of relations between the business and the authorities, limitation of officials' powers to interfere in commercial operations of enterprises would be a positive signal for both domestic and foreign investors. The practical experience reveals that an important problem concerning the relations between the business and the authorities in the country is the unification of key principles and mechanisms of the regulation of commercial operations in regions at the legislative level. Administrations should elaborate and introduce maximally transparent and

effective mechanisms of the use of the state property, otherwise it would be impossible to ensure equal rules of competition for all market participants, taking into account the possibilities the state still disposes of.

Law No. 160 FZ “On foreign investment” has failed to clearly define the registration procedures for commercial organizations with foreign investment. It permitted the federal structures to arbitrarily interpret the legislation currently in effect and practically deprive regions of the right to register such organizations. The law has abolished the previous procedure of registration of organizations with foreign investment allowing the authorities of RF subjects to register enterprises with authorized capitals below Rub. 100 thousand at the place of their location, while enterprises with authorized capitals exceeding Rub. 100 thousand should be registered at the State Registration Chamber. The amended law vests the responsibility to register organizations with foreign investment with the Ministry of Justice. At present, the State Registration Chamber has the necessary jurisdiction; however, it may fail to register all enterprises with foreign investment established in 89 Russia’s regions. Besides, only large organizations may easily bear the costs associated with the visit to Moscow in order to register an enterprise, while these costs may be too high for small and medium sized enterprises.

Therefore, the stipulations of the law concerning the creation, liquidation, and amendment of founding documents of organizations with foreign investment are incomplete and shallow. They infringe on the RF subjects’ rights relating to the registration of organizations with foreign investment and, moreover, can not be applied until the federal law on the registration of legal entities is approved. The impossibility to apply these stipulations resulted in the legal vacuum preventing the creation of organizations with foreign investment.

Directive letters issued by the State Customs Committee instruct regional customs offices not to grant customs privileges to enterprises registered in RF regions. Since these organizations had been duly registered by competent regional authorities, the requirement to additionally register with some other registering agency has no legal force. The unlawful requirements set by the RF State Customs Committee and the RF State Registration Chamber threaten the investment climate, since the abolishment of tax benefits associated with equipment imported by investors considerably deteriorates the conditions of investment.

In the course of discussions on the unfavorable investment climate in Russia, it is often referred to the excessive tax burden. In fact, although it is rather significant, the tax burden is not much heavier than in the majority of European countries. The problems are related rather to the determination of the tax base, than high tax rates. For instance, the rate of deduction of the expenses associated

with the training of personnel and advertising from the tax base is significantly below the actual expenses. The allowances for accelerated depreciation are insufficient. Apparently, this situation prevents investment in high-tech industries, which require massive investment, constant renewal and improvement of equipment, as well as the training of highly skilled personnel.

Even more serious than tax burden is the problem that enterprises are not protected from the arbitrary rule of tax and customs agencies. Wide gaps and serious discrepancies in the tax legislation result in the zones of legal ambiguity. Taking into account the fact that only the state can regulate tax relations, in the situation of chronic budget deficit taxpayers fall under a heavier press of tax agencies. The difficulties encountered in the process of obtaining necessary information about interpretations of changes in the legislation, frequent occurrence of amendments unjustifiably increase costs associated with the monitoring of the legislation and increase fiscal risks, which are a major component of unfavorable appraisal of Russia on the part of investors. The share of risks associated with changes in the national legislation in 1998, 1999, and 2000 made for Russia 22, 18, and 16 per cent respectively, while the average indicator for EU member countries was below 3 to 4 per cent¹⁴.

The Tax Ministry, which lacks the technical capability to cope with the monitoring of the whole totality of taxpayers, has to focus on the most profitable and well known enterprises. This group is in an unequal position with regard to other economic agents.

The policy aimed at the stronger pressure on those who pays, especially foreigners, is the priority policy of the Tax Ministry in the situation where a considerable part of the industrial sector has collapsed, but has not been reorganized yet. The practices comprising individual agreements with large taxpayers about payment terms not stipulated by the legislation, write-offs of accumulated payment arrears, and influence of lobby groups undermine the stability and sufficiency of budget revenues and are an additional burden on conscientious taxpayers. These unequal positions of different economic agents result in the negative selection of economic agents and narrower tax base.

Problems of political institutions in Russia. The most important component and a necessary condition for the development of modern business is an efficiently functioning judicial system. At present, the court practices in Russia are in many respects still basing on the Soviet traditions. At the same time, the present

¹⁴ 10. Gloumont R. Investments in Russian economy. Analysis and Recommendations. // Price Waterhouse-Coopers. Corporate Report 2000. (Add. Investment).

realities result in the fact that the changes underway in Russian courts are not to the better.

Today, the judiciary in Russia is not independent enough; therefore, investors can not be sure that their rights and interests would be protected in accordance with the letter and the spirit of the law. Entrepreneurs clearly understand this fact and do not waste time in courts, what results in enhancing criminalization of business relations and decreasing business activity. The fact that courts of different instances are overburdened results in an extremely slow administration of justice, farther deterioration of the efficiency of the system as a tool for the settlement of conflicts, and increased attractiveness of alternative regulators.

Yet another serious problem is related to the practice of enforcement of court rulings. In spite of the fact that after the approval of the Law "On Execution Procedure" the situation somewhat improved, many problems remain unresolved. For instance, bailiffs lack the authority and means to search for debtors' property; therefore, the search for the aforesaid property becomes the responsibility of plaintiffs, who have already borne substantial legal expenses. Besides, serious problems arise in the course of the execution of the rulings passed by arbitration and international courts (for instance, the Stockholm Arbitration Court).

Today, a pressing problem is the judiciary reform. In the general framework of the reform, it would be feasible to create mechanisms allowing to protect courts from the influence of regional elites. It is also important to stimulate the development of the system and practice of arbitration courts as the most effectively operating system of legal protection of enterprises at present, and to expand their jurisdiction and powers.

At present the overlapping existence of general jurisdiction courts and arbitration courts creates problems related to the determination of jurisdiction. The cases of the same type are tried in different courts (general jurisdiction or arbitration courts) depending on the fact if the parties are legal persons or individuals (citizens entrepreneurs), what does not ensure the uniformity of application of legal norms. The existing forms of procedure do not stipulate a special procedure for minor disputes. There is no court specialization depending on categories of cases, what could ensure the proper competence of judges for the examination of complex economic disputes.

Alongside with the reform in the legislative sphere, it is also necessary to implement an institutional reform. In terms of economy, it may be understood as the ensuring of equal competitive conditions of running a business for all participants of the market. In this connection, the most pressing problem is the increase

in effectiveness of implementation of anti-monopoly legislation and responsibility of respective competent law enforcement agencies.

At the level of the executive branch of authority, there should be implemented a complex of measures aimed at the elaboration and use of open and transparent mechanisms of allocation of budget funds at all levels, ensuring of equal access (via tenders) to all state owned resources which may be used for commercial purposes, limitation of legal opportunities to use the administrative resources for business purposes, improvement of the methods of control over the implementation of uniform norms and requirements of the legislation currently in force (including tax, administrative, civil, etc.) for all market operators. All these obviously needed transformations may be implemented only in the course of massive institutional reforms.

The reform of the structure of power and state governance plays a special role in the framework of institutional reforms. The objective situation, which has formed in the country in the last years, is an evidence that the system of power needs an effective mechanism constraining the legislative initiative of RF subjects in case it contradicts the federal legislation and the Russia's Constitution. If the official data are to be believed, in early 2002 on the average more than 26 per cent of legislative and normative acts in force in the RF subjects were not in compliance with the RF Constitution, while 38 per cent of such acts infringed on the principle of delimitation of powers between the federal center and regions¹⁵.

It shall be noted that not only the activities of the federal authorities determine the country's investment climate. The position taken by the local authorities with regard to foreign capital is a key factor of the investment climate. Many regions recognize the usefulness of external investment, therefore they grant investors tax exemptions and other privileges. While in the first half year of 1998 only 5 RF subjects had special laws concerning foreign investment, at present their number makes 45. The major type of incentives stipulated by such legislation are fiscal privileges (concerning the payment of taxes due to regional budgets). However, only first steps were taken in this sphere, and the general picture of the Russian Federation looks rather mixed. Looking closer at the situation, the impression is that Russia is not a single state, but a mix of feudal principedoms with specific regime in each of them. The latter circumstance places Russia at a disadvantage as compared with, for instance, China, which became a symbol of success in terms of inflow of foreign investment in the last years.

¹⁵ A regular report of plenipotentiary representatives of the President in federal okrugs on the situation as on January 1, 2001.

In spite of all the difficulties a potential investor faces in Russia, the situation seems to improve. The achievements of the last years include the approval of the second section of the Tax Code, a decrease in the tax burden on businesses, changes introduced in the Administrative Code with regard to the responsibility and competence of public officials. This year, the flat tax scale was introduced in Russia, what also should facilitate the inflow of foreign capital. There was also announced the transition to the unified system of collection of customs duties and charges. Mass media and governmental agencies actively discuss the issue of liberalization of currency regulations in the economy, what also should be positively evaluated by foreign investors.

On the whole, since recently the authorities have demonstrated that they understand the urgency of their tasks as concerns the improvement of investment climate. It is important that this understanding would focus on the fact that the majority of problems described in this chapter are not exceptional problems of foreign capital in Russia, and that the resolving of these problems answers first of all the common interests of Russia and foreign investors.

Chapter 2.

Investment Attractiveness of the Novgorod Oblast

In the early 1990s, the economy of the Novgorod oblast encountered considerable difficulties. The large industrial potential accumulated over the preceding years was unclaimed for due to the fact that the country has started the transition to a market economy. Radio-electronic engineering was in an especially dire situation.

Therefore, the Novgorod oblast had to search for the region-specific approaches to the market transformations.

Taking into account the specifics of the territory, the region set the following priorities of the economic policy:

1. To rely on internal reserves, pursue an independent economic policy, at the same time maintaining good relations with the federal center.

2. To rely on creation and development of new small and medium sized businesses.

3. To pursue a clear strategy with regard to the order of economic recover: food and processing industry – light industry – mechanical engineering – high tech industries. The region planned to rely on projects promising a fast pay-back of investment.

4. To actively look for and attract investors.

5. To create maximally favorable conditions for investment in the real sector of the economy in order to obtain larger revenues in the future.

6. To rely on target program management and monitoring on the part of the regional administration as concerns prospective and approved by the administration investment projects. To form a “portfolio of investment projects” for potential investors (as of today, the “portfolio” includes 28 projects).

7. To rely on the understanding that a long term targeted policy may be pursued only in case all branches and structures of the regional authorities put forth the common effort in the constructive cooperation with the federal center in the situation of a “social peace” in the oblast.

In the process of formation of the strategy of economic development, there were taken into account the specifics and the potential of the region (marketing of the territory).

The Russia’s economy still remains in a crisis situation. The major took to overcome this situation is the investment in the manufacturing sector of the economy. The economic situation of Russia does not leave hope for a considerable

increase in investment activity of domestic investors in the short term; therefore, foreign investment is the major real source of investment.

In order to intensify investment activity in the oblast's territory, there was chosen the strategy of attraction of external investment, primarily, from abroad by creating a favorable investment climate.

This strategy was facilitated by the fact that the Novgorod oblast has a strategic advantage in terms of its geographical location – between two largest consumer markets of Russia, St. Petersburg (190 km) and Moscow (560 km), close to the border with Belorussia, Baltic states, and Scandinavia, what provides an easy access to the markets of Europe, Russia, and CIS countries.

For potential foreign investors, the most important factors are the good geographical location of the region and the attitude of regional authorities to foreign investors. The Novgorod authorities have based their economic policy exactly on these factors.

The regional leaders are engaged in the promotion of the oblast on world investment markets, for instance, in the course of their foreign visits. Personal contacts at the level of the regional authorities, regional leaders' presentations on economic and investment forums supported by substantial and diverse information on the development of market relations and investment environment in the region as a rule facilitate the interest to the Novgorod oblast. Exactly direct contacts have helped to attract two strategic investors (Cadbury, Dirol) in the region.

In the framework of the economic committee the regional authorities have created the department for foreign investment, which is directly responsible for the elaboration and implementation of measures aimed at the attraction of external investment in the Novgorod economy.

At the same time, a close attention was paid to the creation of the regional investment legislation able to grant investors tax breaks for the implementation of investment projects in the territory of the Novgorod oblast.

The legislation was worked out in cooperation with both domestic and foreign enterprises, and well known consulting firms (Siar-Bossard, Arthur Andersen).

The system of tax breaks and laws fixing these breaks has formed by stages. In December of 1994, there was enacted the regional law "On tax exemptions for enterprises and organizations located on the territory of the Novgorod oblast," which stipulated tax exemptions with regard to the regional tax on enterprises' property and some other local taxes until the investment projects approved by the

regional administration are offset in full, however, the final term of exemptions was set in accordance with deadlines determined by respective business plans.

In their turn, many districts and towns of the region grant enterprises with foreign investment additional privileges with regard to local taxes.

In 1998, the region approved the law "On investment activities in the Novgorod oblast," which comprised all the "rules of the game" for investors.

On January 1, 1997, the Oblast Duma passed the resolution, which for the first time in Russia created economic zones ("areas of preferential treatment") in four oblast's districts, where there were created conditions for the development of all forms of businesses. In these districts, commercial organizations (except trading organizations) were exempted from all regional and local taxes, besides, the profit tax they paid to the budgets of all levels, VAT due to the regional budget, and payments for the use of the forestry fund were to be reimbursed to the taxpayers from the regional budget. The total amount of tax breaks made 64 per cent.

Since 1996, the regional authorities have paid a special attention to the promotion of the oblast's image in the investment space.

Simultaneously, the region developed a favorable business environment. Since 1992, the region has actively implemented privatization. At present, the process of privatization and creation of joint stock companies is practically completed. There were created different structures oriented towards the support of all forms of businesses, and at present the region has in place a whole system aimed at the support and servicing of external investors. This system includes the Chamber of Commerce, business park, techno-park, a leasing company, training and business center of entrepreneurship and small businesses, the interregional marketing center, banks, auditing firms, insurance companies, and other agencies and organizations.

Besides, in Novgorod the Great there was established the Novgorod Investment Promotion Agency (*Russ. abbr. ARPIN*). The agency is primarily responsible for the search for and support of investors looking for an opportunity to invest in the Russia's economy. ARPIN provides potential investors with information, prepares enterprises for investment and promotes the Novgorod oblast as a primary object of investment.

The Novgorod State University has become the center of the system responsible for the continuous training of personnel for the market economy. In this area, the University actively cooperates with universities in Denmark, Poland, Germany, Finland, Sweden, and the USA.

The experience of Western developed market economies is widely used for the training of Novgorod entrepreneurs. The International business school was created in the framework of the "Novgorod training and business Center" in cooperation with the British partner ("Know How Fund").

In 1997 through 2000, the region developed a modern system of telecommunications. Automatic telephone lines connect the oblast with all foreign countries and Russia's regions. Novgorod the Great provides services of digital networks with integrated ISDN services, data transfer networks INTERNET, ROSNET, ROSPAK, RELKOM, and SPRINT. The regional ROSNET standard transmitting network provides inter-district information exchange within the territory of the region. Since 1996, Novgorod was included in a group of 3 cities (the other two are Moscow and St. Petersburg) connected with IBM Global Network. The international satellite communications INMARSAT functions in the regions.

The regional banking sector is well developed. The banking system of the oblast comprise the regional office of the Central Bank, three regional commercial banks and eight branches of Moscow and St. Petersburg commercial banks. Banks of Novgorod have more than 20 direct correspondent accounts with the leading banks in 5 countries of the world such as Uni-Bank (Denmark), Kommerzbank AG, Dresdner Bank AG (Germany), Centrobank (Austria), Merita Bank (Finland). Several investment companies and funds operate in the region.

The oblast was one of the first among the Russia's regions to start the reorganization of the land and real estate market. The work on regional land and forest cadaster was supported by Swedish governmental organizations.

The region successfully develops the real estate market in cooperation with the US Agency for International Development (USAID). In fact, the secondary land and real estate market has been created.

According to the legislation of the Russian Federation privatized enterprises have a right of buying out their land sites on favorable terms. Land can be leased with the right of further buyout.

There is no federal laws embracing land and land ownership rights issues with regard to non-resident legal entities. In this situation the regional administration has elaborated a mechanism guaranteeing the ownership of land plots, on which enterprises with foreign participation are situated. On the territory of the Novgorod oblast, an investor may expect the positive settlement of any issue related to the purchase and use of land and real estate.

The Novgorod Customs office, which renders the whole range of customs services, has been in operation for the sixth year running. In order to deliver qual-

ity services to businesses, 4 custom houses and 3 customs warehouses have been opened in close proximity to foreign investors' enterprises.

It shall be mentioned that no conflicts between the executive and the legislature, or the federal, regional, and local authorities exist in the region.

Mikhail Prusak, who has been heading the region since 1991, had a landslide win (91.5 per cent of votes) in the elections held on September 5, 1999.

The close cooperation and mutual understanding among all authorities, parties, popular movements, trade unions, producers independently of the ownership forms have allowed the Novgorod team to elaborate a common economic policy, determine priorities and avenues of development, ensure the consistency and continuity of transformations.

The development of international relations has facilitated the inflow of investment.

International relations at the regional level include diplomatic, foreign trade, social, educational, and cultural and tourist contacts, projects, and programs.

The region has prioritized the establishment and development of long term relations. Novgorod most actively contacts the Scandinavian countries (Finland, Sweden, and Norway) and the Baltic states (the Netherlands, Denmark, Germany, Poland).

Close cultural, educational, and social contacts exist between the Novgorod oblast and Norway. The region participates in the educational program "New managers for Russia" aimed at the study of the Norwegian experience of the management under conditions of market economy by Russian public officials. The program was launched by the Association of local and regional authorities of Norway.

Long term cooperation exists between the Novgorod oblast and Finland in the area of environment protection: the Novgorod regional state committee for protection of the environment has implemented a project for construction of pump facilities in Borovichi and Shimsk in cooperation with the Finland's Ministry of Environment. The same organizations are working out a joint project of a solid household waste site in Borovichi.

The region has close and fruitful relations with the Danish Ministry for Environment. The Danish government allocated funds for the completion of construction and modernization of biological sewage treatment facilities in Novgorod the Great. This work is continued today. Danish specialists will take part in reconstruction of sewage facilities at a swine farm in the Novgorod region and the development of tourist infrastructure of the Valdai national park.

The Novgorod regional committee for education is implementing an international project "Management in education" in cooperation with the Dutch Ministry for Education. The project has been implemented since 1999.

Cooperation in the area of culture, sports, education, and business relations links the Novgorod oblast with Estonia and Latvia.

The Novgorod oblast maintains official, business, cultural, and educational contacts with Germany both in the framework of sister relations with the town of Bielefeld, and at the level of state and public organizations. The committee for public service of the Novgorod administration actively cooperates with the Konrad Adenauer Fund in the area of conferences on various aspects of local government. In the framework of a humanitarian project for supply of medical equipment from Germany to Russia, the German Civil Defense department granted the Novgorod oblast a set of hospital equipment for 20 patients in October of 1999.

Novgorod the Great is the only Russian town officially included in structure of the restored Union of Hanseatic Cities and actively participates in the Union's activities. In 1993 at the meeting of Hanseatic commission in German city Schtadt the so-called Novgorod project on restoration of Nikolski cathedral (a most significant landmark built in the 12th century, the time of the Middle Ages Hansa Union) in Novgorod was approved. The financial aid for restoration has been granted by Hanseatic cities. On June 12, 1999, during the celebration of 1140 anniversary of Novgorod the Great this cultural monument was opened after the restoration. Representatives of the administration of Novgorod the Great annually participate in international Hansa days. In 2009, it is planned to hold these days in Novgorod the Great. In the framework of sister relations, entrepreneurs from Bielefeld participated in creation of two enterprises: "NBI Transport Service" and "Novtruck."

Both Novgorod the Great and the Novgorod oblast maintain official sister and partner relations with different countries: Novgorod – Moss (Norway), Novgorod – Watford (UK), Novgorod – Nanterre (France), Novgorod - Uusikaupunki (Finland). Sister relations exist also at the level of district centers: Straraya Russa – Lloret de Mare (Spain), Borovichi – Krasnik (Poland), Chudovo – Parainen (Finland), etc.

Sister towns cooperate at the level of town administrations, chambers of commerce, universities, music schools, other educational establishments, libraries, museums. Mass media and non-governmental organizations also take an active part in multilateral cooperation.

Sister relations exist also between towns of the Novgorod oblast and USA (Novgorod the Great – Rochester, Valdai – Cannon City, Borovichi – Binghamton).

The relations between sister cities have been much more than just exchange with delegations and acquaintance with each other.

Novgorod and Rochester implement a joint project concerning the problems of homeless children. Valdai and Canon City participate in the domestic violence prevention program. A number of interesting projects is carried out in Borovichi in cooperation with Binghamton.

In the sphere of business, a special attention may be attracted to a photo service operating on the Novgorod market, especially taking into account the fact that Novgorod's sister city Rochester is the capital of the world known Kodak company.

In the framework of a TACIS pilot program City Twinning, Novgorod the Great cooperates with Strasbourg (France) in the sphere of tourism development. At present Novgorod the Great implements the second joint project with Strasbourg.

Alongside the existing relations with sister cities and Novgorod's ties with Hanseatic cities, the Novgorod oblast develops friendly relations with foreign countries at the territorial administrative level. These relations are strengthened by long term agreements on friendship and cooperation.

The regional administration has concluded long term cooperation agreements with provinces Estfoll and Telemark in Norway, at present there are discussed the prospects of cooperation with the Kuyavo Primorski province of Poland.

The Novgorod oblast has agreements on long term trade, economic, scientific, technical, and cultural cooperation with some CIS countries: 11 regions of Ukraine, 6 regions of the Republic of Belarus (Minsk, Mogilev, Grodno, Gomel, Vitebsk, Brest), and 8 regions of the Republic of Kazakhstan.

The Novgorod region has close ties with Sweden. These ties are a priority in the development of international contacts.

In accordance with the cooperation agreement between the Novgorod oblast and the province of Erebru, which was signed in 1994, there has been implemented a number of joint programs and projects in different spheres: social protection and employment, training of specialists in the area of private farming in the Novgorod oblast, creation and introduction of an automated system of land cadaster in all districts of the Novgorod oblast. In the framework of an agreement

with the Sweden's land service "Swedsurvey," the North West training center for cadaster and land information systems has been established in Novgorod.

The Novgorod State University named after Yaroslav the Wise actively cooperates with the University of Erebru, and the higher education establishment on Gotthland.

In 1999, there was completed the first stage of the project for water control in the lake of Ilmen and its tributaries implemented with the support of the Swedish agency for environmental protection.

The government of Sweden considerably supports the development of cooperation between the Novgorod oblast and Sweden via such organizations as the Swedish Foreign Ministry, Swedish Institute, SIDA (the Swedish agency for international cooperation), LRF (association of Swedish farmers).

In 1999, the Swedish government allocated s. Kr. 16 million for the implementation of the long term project "Development of local governments and potential of state governance in the Novgorod oblast." At present, SIDA reviews projects aimed at the cooperation in the social sphere involving social services, employment department, and the Novgorod State University named after Yaroslav the Wise.

SIDA assisted the publication of an informational leaflet in English about Novgorod the Great and the oblast.

The Novgorod region has established contacts with environment protection organizations in provinces Erebru and Vermland (Sweden). Some measures were implemented in the framework of the project "Waters of lake Ilmen and Elmarren."

The cooperation of the Novgorod State University with educational establishments in sister towns and territories plays a significant role in the development of international cooperation. This cooperation is facilitated by the fact that the University has connected to the global Internet network. An illustrative example of fruitful international cooperation is the Center for education and development of business NORMAN, created at the Novgorod University in cooperation with the Telemark college (Norway) in 1993. The Norway government has evaluated project NORMAN as the best Norwegian project in Russia.

The Novgorod University implements student exchange programs with universities of Bielefeld (Germany) and Nancy (France), Uppsala University and Gotthland College (Sweden), Academy of Abo (Finland), and Rochester (New York) and Purdue (Indiana) Universities in the framework of the program "Russian American exchanges."

Novgorod higher education establishments successfully develop cooperation programs with their American counterparts. The Russian American School of busi-

ness administration (RASBA) at the Portland University has operated for three years. Many representatives of administrative and business circles of Novgorod the Great have successfully graduated from this school.

In the framework of the project "Partnership for Peace," the University of Rhode Island and the Novgorod University work out a program aimed at the training of public officials. The same university assists the Novgorod University to work out a business administration program for students of the university. The University of Cleveland aids the Novgorod University to elaborate the plan of studies and the methodology in the area of business principles for the law department and to establish the Center for legal assistance.

Friendly relations exist between Novgorod and the Russian American Chamber of Commerce (RACC), which comprises more than 450 American corporations accounting for over 90 per cent of the Russian American trade and American investment in Russia. The RACC chief goal is to facilitate the formation of a favorable climate in Russia for trade, economic, industrial, and investment cooperation between American and Russian businesses. It has become a good tradition that RACC representatives visit Novgorod to work with the local businesses.

The Indianapolis Chamber of Commerce in cooperation with students of the Purdue University (Indiana) has organized a trade show of Indiana companies in order to establish contacts with local potential partners.

In year 2000, there was discussed a project for the creation of a single information network by connecting informational resources of organizations engaged in the servicing of businesses and non-governmental organizations to the existing Internet server "Novgorod the Great for a businessman."

In Staraya Russa, there was established the Center for support of women's entrepreneurship, which provides training and consultations for women starting their own businesses.

The Novgorod Chamber of Commerce has received two grants for the total amount of US \$ 84000. The first grant was aimed to organize exhibition activities in Novgorod the Great, including training seminars, equipment (computers, fax machines); the second grant should be used to improve economic and financial management of the Novgorod Chamber of Commerce and regional administration (US \$ 15000), the rest of the grant should be spent for the purchase of a mini-typography, exhibition equipment, and computers. The region also received two grants (totaling US \$ 65000) for the setting up a Geographical Information System (GIS) for the Novgorod Oblast (purchase of computers, software, and training of personnel).

Carana corporation and Citizens Democracy Corps (CDC) took an active part in the implementation of this project.

In 1997, specialists of Carana corporation (an American consulting company) worked in Novgorod the Great in order to study the regional investment environment and train specialists of Novgorod companies “Planeta” and “Splav” in the area of efficient management techniques.

Basing on the study of the regional investment climate, the Carana experts worked out the recommendations, which were taken into account in the course of elaboration of the regional investment promotion program implemented in 1997 through 1998.

In accordance with Carana’s recommendations, “Splav” has launched an investment project in cooperation with the “Dresser Industries” company (USA). “DS Controls” manufactures valves for petro-chemical industry.

The main outcome of the Carana activities in 1997 was the setting up the Novgorod investment promotion agency, which at the moment is a part of the international Fund of Strategic Initiatives and accounts for a number of positive examples of attraction of external investors to the Novgorod economy (for instance, in 1999 through 2000, there was implemented a project for production of cigarette packages “Amcor Rench”).

In 1999 through 2000, Carana corporation worked on a project aimed to train Novgorod specialists and managers in the area of international accounting standards (IAS) and introduce this method in the standard business practices.

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In 1999 through 2000, Carana corporation worked on the project “The accounting reform in the Novgorod region” aimed to train Novgorod specialists and managers in the area of international accounting standards (IAS) and introduce this method in the standard business practices.

In accordance with Carana’s recommendations, “Splav” has launched an investment project in cooperation with the “Dresser Industries” company (USA). “DS Controls” manufactures valves for petro-chemical industry.

The Novgorod CDC branch was created in July of 1995. Since then, it has been working on the Enterprise and Economic Development Project (EED). The activities of the Novgorod project "Partnership for freedom" was aimed at the search for small and medium sized businesses ready to receive technical and informational support for their further development and attraction of investment in case the following measures would be taken:

- accelerated development of a competitive land market via the creation of the real estate register, introduction of a tax on real estate in Novgorod the Great and regional municipal entities, and the creation of a system of geographical information in the Novgorod oblast;
- attraction of capitals for small businesses via the development of financial infrastructure having the resources and capacity to issue loans to and invest in small businesses;
- improvement of the capacity of higher education institutions to educate and train students in the areas of business, finances, law, real estate operations;
- creation of a package of documents concerning the legal regulation and study of the market of Novgorod the Great for attraction of investment, development of trade, tourism, and prospective projects;
- creation of an accessible database on the Novgorod region.

The project developed along the following avenues:

1. Support and financing of small and medium sized businesses.

There was conducted the micro-financing of small and medium sized businesses, primarily owned by women. More than 700 individual and group loans were granted through the cooperative "Perspektiva," there was created about 800 new jobs.

The program of Citizens Democracy Corps (CDC), which involves professional American business experts (volunteers), delivers advice and technical assistance to Russian small and medium sized private enterprises, municipal and non-governmental organizations, administrations, and business support institutions to build local capacity.

CDC consultants have helped Russian enterprises to resolve problems related to management, marketing, financial planning, training of personnel, etc. Since 1995, 40 CDC consultants worked on more than 100 projects (including lectures, seminars, and conferences) in the region.

An analysis of requests for services of American business consultants from Russian enterprises revealed that almost every third request included search for a partner. In this relation, the program should be expanded and include a “Search for a business partner” project. Now, enterprises involved in the program have the possibility to find an American partner, what facilitates the implementation of such projects.

CDC volunteers have consulted many Novgorod enterprises: “Arkon,” “Adept,” “Deka,” the Novgorod Chamber of Commerce, “Galichi” company, Novgorod taxi service, “Beresta Palace” hotel, etc.

In 2000, the Foreign Investment Advisory Service (FIAS) experts studied the accessibility of markets for entrepreneurs (investors) on the territories of St. Petersburg, the Leningrad, Novgorod, and Sverdlovsk oblasts. The study concerned administrative barriers preventing organization of private businesses in these four regions. FIAS recommendations should facilitate the dismantling of these barriers in the oblast. The practical recommendations were elaborated by end-2000. In October of 2000, Novgorod hosted the final conference of the program “Regional initiative” – “The Novgorod experience for Russia’s regions.”

In late 1997, the Novgorod oblast was included in the program “Transform” implemented by the German government at the expense of German federal budget. Initially, the project was aimed at privatization, restructuring, and post-privatization development of Russian enterprises. Later, the Novgorod administration suggested that this project should be reoriented towards the search for potential strategic investors in Germany, what was approved by the German embassy in Moscow and the General consulate of Germany in St. Petersburg.

In 2000, the project “Transform” was reoriented towards the development of direct cooperation with German companies.

In December of 1998, the region was selected for participation in the EU Tacis regional program aimed to enhance the investment attractiveness of regions. In 1999 through 2000, in the framework of this project the oblast was given recommendations concerning the improvement of its investment attractiveness, including the ways to promote the region on investment markets and optimize databases.

In 1994 through 1998, the Novgorod oblast participated in the EU program “Ecos Ouverture.” The project “Regional development strategies in Russia” embraced four regions of four European countries:

- region of Glasgow (Scotland),
- region Shannon / Cork (South West Ireland),
- region Sachsen Anhalt (Germany),

- Novgorod oblast (Russia).

After three years of cooperation, the partner regions decided to implement a new joint project. In accordance with the Novgorod oblast initiative, at present there is elaborated a program for creation of an International Center for regional development in Novgorod the Great. These materials should be submitted to the European Commission. The German government supports the new project. At present the work on the setting up this new element of the market infrastructure aimed to more actively attract investment, improve structural policies, and train personnel is underway.

The Small Enterprise Assistance Fund (SEAF) finances operations of existing prospective manufacturing and service enterprises via purchase of shares in such enterprises.

In Staraya Russa, there was established the Center for support of women's entrepreneurship, which provides training and consultations for women starting their own businesses.

2. Health care reform.

The creation of the Center for Family Medicine is underway.

3. Land reforms.

In the framework of this project, there was set up and developed a Geographical Information System (GIS) for the Novgorod oblast. The American partners assisted the region to implement the project "Registration, use, zoning, sale of land. Preparation for the introduction of the real estate tax." In the framework of this project, there was created a database relating to the zoning and use of land, established title to land and real estate; there were prepared documents relating to the sales of land plots; there was published a manual for employees of local administrations covering the development of the land market.

4. Education and human resources.

A number of projects is related to the cooperation between the Novgorod University and US universities embracing the training of specialists in the sphere of economy, business, and law. Under the exchange and practical study program, officials of the human resource departments of the town and regional administrations visited the USA. Fifty business persons from Novgorod the Great underwent a six week practical training in American companies.

The implementation of the program of Internet development allowed to open 5 public Internet channels in educational establishments and in the Novgorod children's library.

The organizations “Achievements of the young” provides training for school teachers in applied economics. The program is aimed at the introduction of business programs in secondary schools.

In year 2000, there was discussed a project for the creation of a single information network by connecting informational resources of organizations engaged in the servicing of businesses and non-governmental organizations to the existing Internet server “Novgorod the Great for a businessman.”

5. Trade, tourism, investment.

The American printing company “Alphagraphics” has opened its office, which renders copying, publishing, and design services in Novgorod the Great.

The consulting company Arthur Andersen, which had cooperated with the Novgorod oblast for a long time, maintained its contacts with the region in the framework of the program “Regional initiative.” The company worked on investment projects in cooperation with the “Novgorodaudit” company and organized seminars at the law department of the Novgorod University named after Yaroslav the Wise.

The DHL company, the world leader in the area of express delivery of documents and packages, has opened its office in Novgorod the Great. DHL services are now available to the residents of the region.

“Finnish Holdings Oy” (a subsidiary of Owens Illinois Inc.) is implementing its project of production of glass containers in Novgorod the Great.

The material and technical assistance permitted the Novgorod Chamber of Commerce to improve the quality of its services and intensify its exhibition activities.

6. Civil society and non-governmental organizations.

Since December of 1997, the Eurasia fund has extended about 40 grants to local non-governmental organizations in order to expand their services in the social sphere and to develop local communities. In Novgorod the Great and other territories, there were set up centers for support of not-for-profit organizations, which are developing at the moment.

The office of the Regional Initiative operated in Novgorod the Great from 1997 till 2000. In October of 2000, Novgorod hosted the final conference of the program “Regional initiative” – “The Novgorod experience for Russia’s regions.” Some programs of the Regional Initiative are still underway in the region.

6.1. The outcomes of the “Partnership for freedom” project were micro-credits extended to small and medium sized businesses, primarily owned by women. More than 700 individual and group loans totaling to Rub. 8 million were granted through the cooperative “Perspektiva,” there was created about 800 new jobs;

some enterprises were granted funds for the preparation of business plans, after these plans were approved by the business park and leasing company experts, loans were granted to these enterprises;

6.2. In order to support small and medium sized businesses, representatives of the US Agency for International Development (USAID) have worked out and presented the strategy of support of small businesses, organized several seminars for local business persons, stimulated a dialog between the authorities and business circles.

6.3. The "Transform" project resulted in the elaboration of economic standards aimed to attract investment in the region; there was worked out the concept of restructuring and subdivision of Novgorod enterprises aimed to accelerate privatization. At the moment, this program is being implemented in the region. Novgorod enterprises started to cooperate with German partners ("Planeta SID" – "Signal Konstrukt," "GARO" – "Hoffman," "Novgorodmebel" – "Buromoebel"). Fifteen German companies interested in cooperation and direct contacts with Russian partners in Novgorod were selected in the framework of the program.

Seven enterprises out of the seventeen examined ones were included in the list of potential participants of the project for cooperation, subdividing, and restructuring (in Novgorod the Great, the Borovichi, Chudovo, and Pestovo districts). There was held a seminar "Management of state property (corporate governance)." It is planned to facilitate the setting up of an agency for the management of real estate and to continue consultations aimed to improve corporate governance and training of employees of the administration and managers of enterprises with state participation.

Enterprises proposed by the regional economic committee and some others were evaluated, and there were worked out recommendations relating to their participation in the project.

This work will be continued. It is planned to work out further recommendations concerning the subdivision of enterprises and cooperation with foreign partners. The work on the preparation of contacts has been intensified both in Germany and in Russia.

6.4. In 1999, the Novgorod regional administration presented the following recommendations with regard to the project aimed to expand and develop the major project "Novgorod oblast administration support in the area of privatization":

To work out proposals (recommendations) aimed to facilitate the region's access to the international market of tourism. The administration plans to include

in the project state non-privatized tour operators and privatized small and medium sized tourist companies.

To elaborate recommendations on privatization of the Novgorod airport and the general concept of its restructuring.

To study and develop exhibition activities in Novgorod the Great in order to establish a private enterprise for cooperation with international professional partner organizations and investors.

6.5. The region successfully cooperated with the USAID in the development of the real estate market.

The Novgorod region became one of the first among the Russian regions to start the development of land and real estate market. The work on regional land and forest cadaster was technically supported by Swedish governmental organizations.

At the moment, the region continues to work out other cadaster systems, including mineral, raw material, water resource cadasters, to establish the system of ecological monitoring. The International North West Training Center of Cadaster and Land Information Systems was established in Novgorod the Great. The Center trains experts for the work on the cadaster.

In 1996, experts of the Foreign Investment Advisory Service under the International Financial Corporation and the World Bank actively worked in the region. The outcome was the recommendations aimed to improve the environment for private businesses and attraction of a large amount of foreign direct investment for the development of the Novgorod oblast. These recommendations are used by the department for external economy of the Novgorod regional economic committee and are taken into account in the system of support and development of small and medium sized businesses, which formed in the region in the second half of the 1990s.

In cooperation with the US Agency for International Development (USAID), Novgorod the Great and Tver were the first in Russia to prepare for the experiment aimed to transform the existing taxation system, which was started in January of 2000 and now is continued by the region itself. It was aimed to change the taxation system basing on the real estate ownership. At present the region continues to develop the real estate market. A great effort was made to inventory all real estate objects and land plots in Novgorod the Great (zoning).

Chapter 3. Creating Favorable Environment for Investors: Methodological Aspects Employed in the Novgorod Oblast

The Novgorod regional and local authorities develop the investment legislation in the direction of systematic improvement of stipulations of the federal normative acts as allowed by their jurisdiction and the available means. At present, the region has the investment legislation, which is a guideline for many other country's regions.

The regional legislation may be classified in three groups: guarantees for investors, tax benefits, measures aimed to increase the investment attractiveness of the region.

The executive authorities facilitate investment activity by setting up a system of guarantees for foreign investors.

The system of guarantees developed by the administration comprises the following:

- A guarantee fund created in accordance with Article 39 of the regional law "On the regional budget for 2001" (Rub. 100 million - about US \$ 3.5 million);
- Free information services for potential investors;
- The monitoring of prospective projects by the Regional Administration, which assists in solving problems including those concerning federal authorities.

Investment promotion aimed to attract investors is carried out along three different, but mutually complementary avenues:

- 1) Improvement of the region's image in the view of the investment community as a favorable location for investment (image forming activities);
- elaboration and publication of advertising and informational leaflets, often in cooperation with foreign organizations, describing the investment climate in the Novgorod oblast in English and Russian;
- publications on the investment environment in the region (articles by or interviews with oblast leaders) in domestic and foreign mass

- media (“*Ekonomika i zhizn*,” “*Economist*,” “*Wall Street Journal Europe*,” “*New York Times*,” “*Christian Science Monitor*,” etc.);
- organization of direct mail marketing campaigns (mailing information about the Novgorod oblast to embassies and consulates of foreign countries and offices of large foreign companies);
 - setting up and development of a Web site of the regional administration, which includes information about the Novgorod oblast, investment proposals of local manufacturers and service providers, description of the investment climate, and other useful data.
 - general informational seminars on the investment capacity of the region;
 - participation in investment seminars in Russia and abroad.
 - 2) Direct attraction of investment (measures directly aimed to attract investment);
 - participation in the Investment Project Exchange BORITECH 95 and 96;
 - organization of visits of investment missions to the region (Korea, the Netherlands, Poland, etc.);
 - establishment and maintenance of contacts with foreign organizations, agencies, and companies (correspondence and visits of their representatives to Novgorod the Great and the Novgorod oblast);
 - creation of databases with regard to investment proposals of Novgorod regional enterprises and vacant industrial sites. Potential partners are granted free access to this information;
 - elaboration and implementation of the “Integrated plan of measures aimed to stimulate domestic and foreign investment in the economy of the Novgorod oblast.”
 - 3) Rendering of services for prospective and existing investors (activities aimed to render investment services):
 - consultations in the area of investment;
 - assistance to obtain licenses and permits;
 - rendering of post-investment services.

This avenue of activities is related to the work on the legislation and to a considerable extent supports this legislation by increasing its effectiveness and sending the most important signal for a foreign investor – the favorable attitude of the authorities.

The attraction of investment in the Novgorod oblast was facilitated by the approval of regional legislation aimed to grant investors tax breaks and benefits for the implementation of investment projects.

The legislation was worked out in cooperation with leading foreign consulting companies. The methods of calculation of the full offsetting period of projects were elaborated by the world known consulting company Arthur Andersen and fixed in a law.

Enterprises investing own or borrowed funds in the implementation of projects on the Novgorod oblast territory are exempted from 50 per cent of the total amount of taxes.

In general, an enterprise investing on the territory of the Novgorod oblast pays 30 per cent taxes due to budgets of all levels and extra-budgetary funds less than in other Russia's regions.

Administrations of the region, towns, and districts have set up the practice to monitor prospective investment projects. Administrations facilitate the implementation of such projects, assist in solving different problems, among those related to the federal authorities. Project coordinators chosen among the regional and local officials are appointed, who work with investors since the moment of decision on the implementation of a project, from the registration of an enterprise till the beginning of its operations, and in some cases even longer in order to optimize the processes of establishment of an enterprise; however, these officials do not interfere in the "internal" operations of respective companies.

Among the advantages offered by the Novgorod investment legislation in comparison with the new federal law "On foreign investment in the Russian Federation" there are the following: on the territory of the oblast it is guaranteed that conditions existing at the moment an investment project is started by a domestic or foreign organization as determined by regional normative acts will be preserved for the full offsetting period regardless of the amount of the project. At the same time, the federal law guarantees that initial conditions will be preserved only for seven years and this stipulation may be applied only to organizations with a share of foreign capital exceeding 25 per cent, or those engaged in priority investment projects.

The Novgorod oblast strives to compensate, to the extent of its competence and available financial resources, the flaws in federal normative acts and changes in the federal legislation, which worsen the conditions for investors.

For instance, in the case the tax benefits relating to an investment project are reduced, the region prolongs the term of tax grace period and guarantees that the starting conditions will be preserved for the whole estimated offsetting period of the project.

The region actively worked out policies for attraction of investment thanks to the technical assistance of international and foreign organizations.

In fact, the secondary land and real estate market has been created in the oblast. The process of privatization and transformation of enterprises in joint stock companies in the region is practically completed.

Privatized enterprises have a right of buying out their land sites on favorable terms. Land can be leased with the right of further buyout.

Any investor can expect positive decisions with regard to purchase and use of land and real estate, since the region has in place a flexible system of settlement of these issues.

At present, in cooperation with the group of companies "Invest In," a number of territories of the region prepares lists of vacant industrial sites ready for investment for potential investors.

The recommended strategy and tactics of development of investment attractiveness of RF subjects may be implemented taking into account the Novgorod oblast experience along the following guidelines.

In order to create investment climate:

- the region has approved the law "On non-worsening of the legislative conditions of enterprises' operations existing at the moment the decision on investment was taken";
- The local government provides investors with every support by means of guaranteeing assistance to investors. A Guarantee Fund was created within the regional budget.
- A wide choice of vacant production sites including all the necessary infrastructure (such as gas, water supply, electricity, refining systems and so forth) is offered to investors. There was set up the database "Vacant industrial sites," which covers all towns and districts in the oblast. It is possible to purchase fixed assets of a bankrupt enterprise for one conventional Ruble regardless of their real value in case an investment project is presented. Factory debts are cancelled and the property, which is not currently in use, is exempted from taxes in the case a prospective investment project is carried out (the law "On conservation").

The special agency provides free information to potential investors. The region has elaborated a manual for business persons listing all local and federal organizations and indicating the concrete persons the investor will contact with in the process of organization of the enterprise, key issues of cooperation, and the applicable normative acts.

The region cooperates with banks and insurance companies, which insure risks associated with the implementation of investment projects. The Novgorod oblast involves commercial structures of large Russian financial centers, international and foreign financial and insurance institutions in this process. About ten investment funds and companies operate in the region.

The assets, which are not currently in use, are exempted from the property tax in the case prospective restructuring projects associated with investment are presented; there was also set up a fund of non-liquid assets.

It may be profitable to grant benefits to investors. In fact, the oblast also is an investor, since two thirds of benefits are in the jurisdiction of RF subjects.

At the same time, it would be feasible to limit the grace period in order to prevent successful and profitable enterprises from using this benefit.

In the case the region provides good conditions for businesses, a system of benefits, project monitoring and tax breaks, investment projects are implemented in the oblast. Therefore:

- new jobs are created, wages and salaries grow;
- unemployment decreases;
- expenses of the employment funds decrease;
- regional financial turnover intensifies;
- producers have an opportunity to borrow from banks for implementation of investment projects, since the project related benefits in their working capitals suffice to pay the interest on credits;
- auxiliary facilities and infrastructure servicing the operations of newly created enterprises (transport, agriculture, packing, related services, etc.) develop;
- payments to extra-budgetary funds (pension, social insurance, employment) increase;
- and, last but not least, the budget receives additional revenues related to the individual income tax.

Chapter 4.

Investment in the Real Sector of the Novgorod Oblast

The creation of a favorable investment climate and the approval of investment legislation in 1994 have resulted in the increasing inflow of investment in the economy of the Novgorod oblast.

The specific weight of foreign investment in fixed assets of large and medium sized enterprises (taking into account all sources of financing) made 36.4 per cent in 1998, while the national average was 6.2 per cent in 1998 and 30.7 per cent in 1999.

In 1999, 96.4 per cent of foreign investments were made in the food sector of the regional economy, 1.7 per cent – in forestry and woodworking. In 1998 through 1999, the share of direct investment increased twofold, as compared with figures registered in 1997.

The per capita foreign direct investment in the Novgorod oblast in 1999 was three times more than the national average (US \$ 44.8 and 15 respectively).

In 1999, 14 countries invested in the Novgorod economy. The largest investors were Denmark and Great Britain. The total amount of investment from Denmark made US \$ 53 million, while Great Britain invested US \$ 31.9 million (60.2 per cent and 36.2 per cent of the total amount of investment respectively).

In 1998 through 1999, the structure of foreign investment in the region changed. While the share of direct investment increased from 17.1 per cent to 37.1 per cent, the share of other investment fell from 82.9 per cent in 1998 to 62.8 per cent in 1999.

The amount of foreign direct investment in 1999 made US \$ 32.7 million, what is 4.3 times more than the respective indicator registered in 1998. This increase was achieved primarily at the expense of direct investment from Denmark, which actively invested in the regional food industry. This industry still attracts foreign investment (in 1999, the investment in food industry increased 2.1 times in comparison with figures registered in 1998).

The share of foreign investment in this industry in the total amount of investment increased up to 96.4 per cent. Foreign investment in food industry made US \$ 84.9 million, of which foreign direct investment made 35.5 per cent (other investment made 64.5 per cent, including 37.3 per cent of EBRD credits).

In 1999, the structure of inflow of foreign capital from largest investor countries changed in comparison with figures registered in 1998. The share of foreign

direct investment in the total amount of investment increased (for instance, in 1999, the share of foreign direct investment from Denmark and Great Britain made 35.5 per cent as compared to 10 per cent in 1998).

In 1994 through 2001, the Novgorod oblast attracted US \$ 536.5 million in foreign investment (as registered on January 1, 2001).

Table 4.1.

Foreign investment as broken down by industries

Industry	US \$ mil.	%
Food	371.9	56.3
Chemistry	165.6	25.8
Forestry and woodworking	60.2	9.4
Transport	16.8	2.6
Communications	2.4	0.4

Foreign investment as broken down by leading countries

Country	US \$ mil.	%
Great Britain	232.5	34.6
Denmark	139.5	20.8
Gibraltar	137.8	20.5
USA	65.2	9.7
Finland	44.3	6.6
Germany	22.5	3.4

The largest amounts of foreign investment have flowed in food industry – 56.3 per cent, chemistry – 25.8 per cent, forestry and woodworking – 9.4 per cent, industry of construction materials and communications – 3 per cent. The specific weight of foreign investment in fixed assets of large and medium sized enterprises (taking into account all sources of financing) made 27.6 per cent in 2000, 30.7 per cent in 1999 (in 1998 – 36.4 per cent), while the national average was at 6.2 per cent.

In year 2000, 62.7 per cent of foreign investment flowed in the regional food industry, 33.5 per cent – in forestry and woodworking.

In 2000, the largest investors were Denmark (32.7 per cent), Germany (31.7 per cent), and Great Britain (25.6 per cent).

Organizations of all forms of ownership used Rub. 5200 million of investment in fixed assets for the development of the economy and social sphere in year 2000. The internal funds of enterprises remain the major source of investment in fixed assets.

As a result of the effort made to attract foreign investment, in year 2000 there were registered 17 organizations with a share of foreign capital in their au-

thorized funds totaling to US \$ 4 million. The total amount of foreign investment in the non-financial sector of the regional economy made US \$ 49.5 million over the year.

Regional enterprises have completed or still implement 185 investment projects, including 33 projects with foreign investments totaling US \$ 480 million. In 2001, as a result of political stability and consistent improvement of the regional investment climate, foreign investors continued to demonstrate their interest in the Novgorod oblast.

The candy producer Cadbury (which started operations in 1996) was followed by Dirol bubble gum producer Dandy, which opened its plant in Novgorod the Great in August of 1999.

The American Association of construction management has awarded the Dirol investment project in Novgorod the Great run by Hanscom company the title of the best project of 1999.

The “Novgorod telecommunications” has launched a TDMA communications network of Ericsson company in the region.

The German firm Pfeleiderer has organized the production of modern insulation materials Ursa at the premises of a glass manufacturing plant in the town of Chudovo.

The Australian concern Amcor Rench has launched a package production line in Novgorod the Great in September of 2000.

Novgorod enterprises with foreign investment play a significant, if not decisive, role in the regional economy.

The share of enterprises with foreign capital in the total volume of industrial output of the Novgorod oblast has exceeded 68.2 per cent, while the respective national indicator made 11.4 per cent in the first half-year of 2000. The share of such enterprises in regional imports and exports makes 80 per cent and 30 per cent respectively.

The average number of employees at enterprises with foreign investment in Moscow and St. Petersburg made 44 and 97 employees respectively in 1999, while in the Novgorod oblast this indicator was at 850 employees. At the same time, the average amount of output of such enterprises in Moscow and St. Petersburg made Rub. 47 and 65 million respectively in 1999 as compared to Rub. 417 million in the Novgorod oblast.

The Novgorod oblast is the target not only of foreign, but also domestic investment, since the regional legislation offers similarly favorable conditions for both foreign and domestic capital. Russian investors (well known “Cherkizovo meat packing plant” and “Dovgan” corporation) accounted for Rub.

93 billion of investment, while Gazprom is planning to invest in construction of an underground gas storage tank in the region.

In 1999, organizations of all forms of ownership used Rub. 4143.5 million of investment in fixed assets for the development of the economy and social sphere, what 1.6 times exceeds the level registered in 1998.

In 1998 through 1999, the major part of domestic investment was directed to the fixed assets of enterprises of food industry and transport. The internal funds of enterprises remain the major source of investment in fixed assets.

In 1999, the oblast moved 13 positions up in the ranking of production potential and was ranked fourth in Russia in terms of rates of growth in industrial output. The only factors behind this success were regional resources of skilled labor and favorable transport and geographical location.

The Novgorod oblast is constantly ranked among top ten regions with least risks by the Ekspert magazine. The effort to attract foreign investors has brought its results. While the Novgorod oblast is ranked 68th in terms of the size of population, the consulting agency “Ekspert Geografiya” asserts that in terms of foreign direct investment the region is ahead of such developed regions as the Novosibirsk, Saratov, Voronezh, Yaroslavl, and Ulyanovsk oblasts, while in terms of per capita domestic and foreign investment the Novgorod oblast is ranked 2nd after Moscow.

The region cooperates with 40 countries in the area of investment, more than 100 enterprises with foreign investment and 20 thousand employees function on the Novgorod territory. The largest of these enterprises receive investment from companies located in EU countries. Among the investors are such famous companies as “Wood Schauman”, “Raute”, “Owens Illinois Finnish Holdings Oy” (Finland), “Cadbury” (Great Britain), “Dandy” (Denmark), “Sommer”, “Pfleiderer” (Germany), “Amcor Rensch” (Australia), “Holzindustrie Prading” (Austria), “Dresser”, “JIR Broadcast Inc” (USA).

At present, the region implements or prepares to implement the following large projects:

- The subsidiary the American concern “Owens Illinois” “OI Finnish Holdings Oy” is ready to launch the production of glass containers for food, pharmaceutical, and perfume industries;
- The Australian concern Amcor Rensch has set up a cigarette package production line in Novgorod the Great in September of 2000;
- The Spanish candy and bubble gum producer “Joyco Group” is preparing to launch its production lines at the premises it leases from Stimorol Chewing Gum;

- The German company “Kraft Foods” (the owner of famous brands of coffee, candies, chips) prepared to set up the capacities for production of chips and starch in the Novgorod district in 1998 through 2000, at present the company is planning to launch similar production on the territory of the region.

At present the oblast negotiates with foreign companies from Germany, USA, Finland, Sweden, and Estonia about the implementation of investment projects in the area of electronics, mechanical engineering, woodworking, chemical, food and other industries.

The oblast was first among all Russia’s regions to be awarded the European Council banner of honor for the development of international contacts. In 1997, the American Chamber of Commerce conferred on the region the title of the region of the year for the successful implementation of economic reforms in 1997. In 2001, the oblast was awarded the honorary badge of the Council of Europe for its achievements in international activities and integration in the European community.

According to the Ekspert magazine (No. 41, October 30, 2000), Moscow and the Novgorod oblast are two undisputed leaders in the area of investment attractiveness. In terms of investment risks, the Novgorod oblast, the only region classified in the group of RF subjects with a low potential and minimal risks, is ranked second in terms of investment attractiveness. For the fifth year running, the Novgorod oblast demonstrates the lowest level of risks among 65 regions with low potential.

Eleven RF regions included in the group “very low level of investment risks” account for more than 40 per cent of the national amount of investment, while their population makes only 20 per cent of the total RF population. Although the level of investment attractiveness of the Novgorod oblast is 14 per cent above the national average, it demonstrates the rate of change in capital investment, which is 24 per cent above the average level in Russia (Investitsii v Rossii, No. 12, 1999).

According to the World Bank, domestic and foreign experts working in Russia (the international consulting firm McKinsey, auditing and consulting group of the Ekspert magazine, etc.), the major factors of the Novgorod regional investment policies are:

- Political stability;
- Guaranteed maintenance of starting conditions for investment projects (the grandpa clause);
- Granting of equal rights to strategic partners;

- Simplification of administrative procedures.

According to the experts and organizations mentioned above, exactly these factors were a decisive element in the process of attraction of foreign capital and made the region most attractive for investors.

Western experts note that although the region had the starting conditions and problems similar to those of other regions, “normal European processes are underway in the oblast.” The experts specially stress that the regional authorities have managed to put in place an effective investment attraction system free of usual in Russia bureaucratic barriers.

These results could be much better, in case certain pressing problems could be resolved. These problems include the flaws in the federal legislation and the fact that many RF subjects do not have financial resources necessary to form favorable conditions for investors.

Chapter 5.

Developing an Investment - Encouraging Environment: Recommendations

A number of problems, not resolved at the federal level, prevent the inflow of foreign investment in Russia. In order to remove these barriers, the following measures should be undertaken:

- introduce interrelated normative acts relating to investment in a single package (laws on foreign investment, free economic zones, licensing, and certification);
- promptly inform the agents involved in external economic operations about changes in the legislative base, not allow the enactment of “retrospective” orders and instructions;
- ensure the unification of procedures governing the interaction and coordination of state regulating authorities in all areas;
- introduce uniform requirements of controlling agencies as concerns the compliance with legislative acts regulating the issues of customs and tax policies, currency control, certification, sanitary and other norms related to export and import documentation; bring procedures of customs regulation, currency and export control in accordance with Euro-standards aimed to stimulate international trade and investment, which were approved on January 1, 1997;
- draw normative documents for products and services in accordance with respective standards accepted by the international community;
- ensure the transparency of VAT compensation procedures related to exports;
- ensure that all foreign companies complying with RF Presidential decree No. 73 “On additional measures aimed to attract foreign investment in material production industries” have equal opportunities since the moment the investment agreements are signed;

In order to create an attractive image, the region should inform potential investors about the available investment opportunities by conducting advertising and informational campaigns in mass media, organization of and participation in national and foreign investment exhibitions, presentations and seminars.

Informational support is a necessary element of cooperation with foreign investors, especially in cases the recipient country experiences a change in general

economic or legislative investment environment. The quality of information plays an important role in economic development, since:

- the extent and availability of information determines the level of the competitiveness of the market and affects the agents' efficiency of distribution of resources and their evaluation of risks and necessary profitability rates;
- the development of modern communications resulted in a rapid increase in the amount of available information. Therefore, the prompt access to information, confidence in the source of information and the level of respective costs acquire crucial importance.

International practices include the creation of specialized agencies fully or in part owned by the state, which are responsible for cooperation with foreign investors. Such agencies operate in about 100 countries of the world. The agencies perform the following functions:

1. they create favorable image of the country for potential investors;
2. attract investment for implementation of certain projects;
3. render investment related services.

Such an agency was established in Russia on the initiative of the Foreign Investment Advisory Service – Russian Center for promotion of foreign investment.

At the same time, there exist similar organizations, which promote investment using not the budgetary financing, but their own resources. For instance, the Inter-regional Fund of Strategic Initiatives and the Investment Promotion Agency base their operations on these principles.

The targeted attraction of investment is carried out by defining the range of companies whose investment is viewed as the most important for the national economic development. It is feasible to establish direct contacts with such companies in order to interest them in the prospects of investment. An important means of investment promotion would be a national information network providing investors with necessary information.

It is important to clearly define the investment opportunities at the national and regional levels prior to notifying potential investors about such opportunities.

At the same time, the creation of a favorable investment image of Russia is impossible without elaboration of a clear, consistent, and transparent state economic policy and policies related to the promotion of investment activities. The consistent pursuit of such policies is the best promotion of the country's image in the eyes of potential investors.

The investment legislation is fragmented and conservative (the existing laws rapidly become obsolete, while the approval of necessary new regulations is delayed). The law "On foreign investment in the Russian Federation" is flawed due to the absence of mechanisms of its practical implementation, since no related regulations were approved.

The mechanisms of non-market influence on the economy are still in place (for instance, the State Customs Committee has instructed local customs offices not to grant customs privileges to enterprises registered in RF regions).

Certain necessary amendments have been already approved. For instance, there were introduced VAT and customs benefits with regard to the equipment imported as a contribution to authorized capitals of enterprises with foreign investment.

As an example of problems created by the federal legislation, it may be referred to RF governmental resolution No. 1364 of December 9, 1999, "On the approval of export customs duties on goods exported from the territory of the Russian Federation and participants in agreements on the Customs Union," which stipulates a twofold increase in customs duties on timber and paper products and more than a threefold growth in duties on foliate and coniferous lumber.

Forestry and woodworking play a significant role in the economy of the Novgorod oblast. The share of these industries in the regional industrial output makes more than 14 per cent and they provide one of the largest number of jobs for the population. In fact, all forestry and woodworking enterprises are the single sources of jobs and financing at their respective locations. In the last few years, the forestry and woodworking complex demonstrated a stable upward trend and financial stabilization. The amount of output and sales made 108.7 per cent in 1998. The introduction of new export customs duties renders the enterprises to operate at a loss in case they export lumber and technological wood chips, while for enterprises exporting products of woodworking profits fall dramatically. The losses associated with the export of one cubic meter of pulpwood (the staple regional export) and technological chips will make about Rub. 12 and Rub. 112, respectively. The profitability of exports of softwood, plywood, and timber sharply deteriorates.

The regional forestry and woodworking enterprises have concluded export contracts with foreign companies, agreed prices, submitted transport requests for year 2000. In case the enterprises fail to duly perform their contractual obligations, they would have to pay huge fines. As a result, the tax revenues of budgets of all levels were much below targets.

Yet another problem is that the procedure of VAT compensation is too complicated and takes too much time. On February 9, 2000, the RF Tax Ministry issued instruction No. AP 3-18/36, which further complicated the procedure of compensation for VAT, paid on exports. The instruction stipulates that the Tax Ministry will take decisions related to VAT compensation exceeding Rub. 10 million, what considerably delays the compensation and therefore results in withdrawal of more working capitals of exporting enterprises.

The flaws of the legislation, weak judiciary system, and corruption result in a large number of administrative barriers, which hinder investors to implement investment projects. These barriers are primarily associated with registration and re-registration of enterprises and issuance of shares.

At present, an investor must obtain resolutions of 20 to 30 autonomous and located at different premises agencies and 50 to 90 different permits. It is necessary to simplify the procedure governing the organization of businesses and create a technology basing on the "one window" principle. In this case, investors would be able to deal with only one agency and obtain (or be justifiably refused) a permit in a short period of time.

The market access barriers should be transparent, entrepreneurs should clearly determine the amount of investment they need to establish a business. For instance, it is necessary to approve the law "On registration of legal entities."

A number of federal normative acts approved over the last years resulted in worse conditions for economic agents and infringements on RF subjects' rights in the sphere of economy.

Federal law No. 2116-1 FZ of August 6, 2001, "On Amendments to the law of the Russian Federation 'On the tax on profits of enterprises and organizations'" has deprived the RF subjects of the right to grant investors the benefits related to the share of the profit tax due to the regional and local budgets. However, it shall be mentioned that item 9 of Article 6 stipulates that for certain categories of taxpayers implementing investment projects in accordance with agreements on investment activities, the additional profit tax benefits granted by the legislatures (representative bodies) of RF subjects and representative bodies of local governments in effect on July 1, 2001, shall be maintained for the term they had been granted. In case no term was established, the benefits should be in effect until the term of the offset of the investment project, although, not more than for three years since the date the benefits were granted (federal law No. 110 FZ of August 6, 2001).

The administration of the Novgorod oblast believes that these amendments not only discourage investment, but also infringe on the principles of delimitation

of financial responsibility of different levels of the authority, since they relate to the right of regional authorities to grant tax privileges related to the share of taxes due to the budgets of RF subjects. In the case the federal government is concerned with possible abuses in the process of granting tax privileges, such privileges should not be prohibited, but regulated by setting detailed specification of the criteria, amounts, and terms of benefits granted by regional and municipal authorities.

Law No. 160 FZ of July 9, 1999, "On foreign investment in the Russian Federation" abolished the privileges relating to the duties on goods imported for the inclusion in the authorized capital, put in place more strict eligibility criteria relating to state guarantees, and introduced the concept of priority projects basing on quantitative criteria. These projects (amounting to more than US \$ 40 million) shall be approved at the federal level. The concept of priority investment projects and the fact that priority should be approved at the federal level sharply deteriorates the conditions of investment in the Russia's economy for medium sized and small companies. The law has been enforced since July 14, 1999. Since that time it has become clear that the law not only fails to facilitate the formation of a favorable investment climate in Russia, but also prevents implementation of "non-priority" regional investment projects.

A number of normative acts was not amended in accordance with the law, for instance, law No. 5005-1 of May 21, 1993, "On customs tariff," basing on which the Russian government issued its resolution No. 883 of July 23, 1996, "On benefits relating to the payment of import customs duty and value added tax on goods imported by foreign investors as a contribution to the authorized (joint) capital of enterprises with foreign investment," what was confirmed by respective letters of the State Customs Committee and the RF Ministry of Economy, which left in place the previous procedure governing the system of duties and benefits.

At last, it is necessary to reform the system of taxation of small and medium sized businesses, simplify tax procedures, and increase tax rates subject to the simplified taxation system. Small businesses shall be exempted from VAT, while the single social tax on small businesses shall be decreased. The barriers existing within the system of small and medium sized businesses shall be dismantled; however, the entry barriers shall remain in place in order to prevent tax minimization on the part of large companies. Besides, the system of taxation basing on the principle of a single imputed tax shall be voluntary. The Russia's parliament is currently discussing these initiatives, and it remains to hope that the announced measures aimed to decrease the tax burden on small and medium sized businesses will be implemented soon.

Therefore, the important changes in the federal legislation include:

0. to put in place a system of insurance and guarantees of direct investors;
1. to improve and simplify the system of registration of enterprises with foreign investment;
2. to work out of a mechanism allowing to use mortgage for attraction of foreign investment;
3. to simplify VAT compensation procedures related to exports;
4. to allow regions participate in the formation of state federal programs aimed at the further development of external economic activities;
5. to change the concept of “priority investment project” introduced by RF law No. 160 FZ of June 9, 1999, “On foreign investment in the Russian Federation” and extend preferential regimes and guarantees of stability stipulated in articles 9 and 16 of this law to all investment projects implemented in the Russian Federation. It is also necessary to review the possibility to decrease quantitative criteria set by this law;
6. to approve amendments to the law “On state registration of legal entities,” which would grant the RF subjects the right to register enterprises with foreign investment regardless of the amount of the share of foreign capital, even if it exceeds US \$ 100 million. Therefore regional customs offices will be able to grant customs privileges to enterprises with foreign investment not registered in the State Registration Chamber of the RF;
7. to simplify the procedure governing the keeping of the State register of enterprises with foreign investment;
8. to amend the legislative and normative documents of the RF State Statistical Committee in order to make statistical information transparent to the authorities and economic agents.

Annex 1. Developing the Legislative Base in the Novgorod Oblast: Recommendations.

The legislative system of the Novgorod oblast facilitates the investment process, since it includes a number of respective regional laws. No doubt, in general the Novgorod legislation is more developed and of better quality than in the majority of regions. However, it is not free of certain flaws. Below are listed recommended amendments in such important spheres as tax benefits, managing of state owned property, privatization, and the budgetary process.

Regional law **No. 29 OZ “On investment activities in the Novgorod oblast” (as amended on February 7, 2001)** is aimed to facilitate the investment activities on the territory of the region, set up the most favorable treatment for investors, put in place additional guarantees for organizations implementing investment projects. The term “most favorable treatment” is classified as a form of support for investment, however neither this law, nor other Novgorod regional laws clearly define this term. The federal legislation also fails to clearly define this term. The definition of the investment projects includes expenses for creation, increase, and purchase of durable (used for more than a year) fixed assets, what is a positive factor providing certain guarantees of stability of investment and facilitates investments in the real production.

Article 5 of Chapter 3 of the law stipulates that “investment activities in the region are stimulated by granting investors tax benefits... within the amounts due to the regional budget and the territorial road fund.” It remains unclear why the road fund was mentioned in the article. The law fails to put in place the mechanism governing the granting of benefits related to taxes due to the road fund.

The second paragraph of the same article again mentions the “most favorable treatment,” however, it does not set clear criteria with regard to the relations between the regional administration and investors, i.e. the law fails even to mention this term.

The third paragraph mentions “the system of guarantees put in place by the administration” in accordance with the procedure stipulated by regional normative acts, however, no reference to these normative acts is given. It shall be mentioned that Chapter 6 of the law provides certain general definitions and principles relating to this “system of guarantees.”

The fourth paragraph stipulates the setting up of the monitoring of prospective investment projects. However, this term remains unclear in economic terms. Be-

sides, the law fails to mention what authority (the regional or municipal administration, the authorities in general, including the federal authorities) is responsible for the “monitoring”; the term “prospective investment project” is not defined either by the Novgorod regional legislation, or the federal legislation. It is unclear how this criterion shall be determined. Apparently, the most transparent principle of defining the “priority” of a project would be a certain amount measured in minimal wages. In this case, the authorities would provide investors with free informational or infrastructural support after the investment project exceeds this amount. It would be also possible to fix this amount in Rubles as per the exchange rate at the date the investment project was submitted, for instance, at the level of US \$ 40 million. This amount was unofficially mentioned as the criterion for the monitoring of a project by the Vice-Governor of the region.

From our point of view, Article 3 of Chapter 6 unjustifiably excludes trade and public catering from the list of organizations eligible for benefits. These spheres of economic activities are also able to generate profits and be attractive in terms of investment. Besides, the existence of a formalized method of evaluation of business projects and the necessity to obtain the approval of the administration do not allow to grant this benefit too often.

The auditor confirming the estimation of the actual offsetting period for an investment project (paragraph 5 of Article 6) shall be really independent. Therefore, the auditor shall be appointed by a person independent of the investor, otherwise, the “independence” of auditors does not make any sense. Otherwise, this stipulation may be viewed as the lobbying of interests of auditing firms. A possible way out of this situation, in case the auditing of investment projects is maintained, would be a tender among auditing companies, where the winner is granted the right to evaluate all proposals relating to investment projects. It also remains unclear if there exist the criteria of independence of the expert evaluation of business plans (paragraph 3, Article 7). In case the legislators wanted to make the life of investors more easy by granting them the right to choose suitable auditors, it is unclear why the stipulation on audit is included in the law.

The same article fails to define the criteria determining the “feasibility” of tax benefits granted to investors by town (district) administrations (paragraph 6, Article 7), since such a decision should be approved by the regional administration. In this case this provision sets just another barrier for tax benefits. Therefore, in case the regional administration does not intend to grant benefits regardless of the reason, it may make the applicant to submit the document for revision (paragraph 2, Article 8) under any suitable pretext, since the law fails to identify the final list of required documents. It would be feasible to set such a list in the law.

A specific feature of the Novgorod regional legislation is the existence of so called "areas of preferential treatment," which were created only in this RF subject.

Town budgets of the areas of preferential treatment (Article 9) set up on the territories of depressive Batetsk, Volotov, Maretsk, and Poddorsk districts reimburse 100 per cent of certain taxes paid by investors. On the one hand, the law should set the minimal and maximal amounts subject to reimbursement in order to exclude massive losses of the budgets and prevent registration of "one deal" enterprises in these areas. However, on the other hand, it was wrong to exclude trade enterprises from the list of commercial organizations, since they could generate significant profits. The most serious flaw of the article is that it fails to "tie" commercial organizations to locations on the territory of areas of preferential treatment. The criterion of the "place of operation" is too vague and is absolutely inadequate to the logic of the Novgorod legislation aimed to create new taxpayers on the territory of the region. It does not make sense to grant privileges fully exempting enterprises from local taxes. No wonder that in the course of meetings with the Novgorod regional administration it was mentioned that in fact these stipulations of the law do not function, and that the authorities discuss possible amendments of these provisions. It would be feasible to introduce restrictions on the utilization of profits – a certain part of profits derived by organizations should be spent on the territories of the areas of preferential treatment.

An important aspect of investment climate is the policies the local authorities pursue with regard to property. The normative base provided by the Novgorod regional law "On managing state owned property in the Novgorod oblast" (No. 59 OZ) needs a thorough revision.

The functions related to the management of state owned property are vested not with different ministries and agencies, but with the State Property Committee (paragraph 3, Article 7), and the Novgorod regional Property Fund, what is a positive prerequisite. However, the right of the fund to establish commercial companies and partnerships rise certain doubts.

Article 6 of the law thoroughly describes the accounting procedures related to the state owned property on the territory of the Novgorod oblast. The Article defines the term Property register of the Novgorod oblast. Item 5.3 of this article stipulates that an object may be excluded from the register in accordance with a resolution approved by the regional administration, an exchange or donation agreement, while item 5.2 stipulates that the monitoring may be discontinued because of a change in the form of ownership. A possible conclusion is that the regional administration may donate the object to a legal entity and discontinue the monitoring.

Item 6 of the article should be extended as concerns the users of the register. Information contained in founding documents, balance sheets of enterprises, and other financial reports not defined as the commercial secret should be available to all users (not only those listed in the law) and be regularly published on the official Web site of the Novgorod oblast.

Paragraph 6 of Article 8, which defines the management of state owned property, fails to indicate the procedure governing the purchase of enterprises and other real estate from legal entities and individuals by the Novgorod oblast. It would be feasible to fix in the law the procedure of a public tender organized in accordance with clearly defined formalized criteria. Otherwise, such criteria may be set arbitrary, what can result in a formally lawful, but absolutely arbitrary determination of the seller. In each concrete case a single quantitative criterion should be applied in order to determine the consumer. All qualitative parameters should be formalized, measurable in accordance with standard procedures and included in the specification of procured goods (services).

It is necessary to set formal criteria of the “usefulness” of the object procured by the Novgorod oblast in order to minimize misallocation of budgetary resources for purchase of useless assets.

Item 11, Article 8, mentions “other agencies” vested with the powers of executive authorities. It would be feasible to more clearly define the list of executive agencies vested with the right to exercise such powers.

Paragraph 14 should be amended as follows: “regulates special conditions of commercial activities of regional unitary enterprises in compliance with the RF legislation and the enterprise’s charter.”

Paragraph 1 of Article 11 stipulates that regional unitary enterprises may use “other sources of financing not prohibited by the law.” The law should more clearly define all possible sources of financing.

The managers of regional unitary enterprises and joint stock companies with the share of property in the authorized capitals exceeding 51 per cent should be appointed on the contractual basis. Item 1 of Article 12 fails to clearly define the terms of such contracts. Similarly, the article fails to stipulate the detailed procedure of the contest for the appointment (item 3).

In case a regional unitary enterprise constantly operates at a loss for more than two years, there should be organized a contest for the right to manage such an enterprise.

Representatives of the Novgorod oblast are granted the right to use the “golden share,” for instance, to veto certain decisions taken by shareholders’ meetings (item 9, Article 16), however; the law fails to indicate the minimal size of the block of

shares. This procedure is permitted by the federal legislation. "Golden share" enables its holder to significantly affect the operations of an organization; however, it brings only minimal dividends. Therefore, the "golden share" provides an opportunity to participate in the commercial operations of an economic agent by non-market methods, what should be prevented. The practice demonstrates that while the "golden share" brings practically no dividends to the state, it may be used to paralyze economic activities and serve as a source of rent for the official disposing of this share. Therefore, we find it feasible to exclude the concept of "golden share" from the regional legislation covering privatization of enterprises.

Item 2 of Article 15 of the law stipulates that unitary enterprises may found companies and partnerships only at the expense of their profits. Otherwise they need to obtain an approval of the Property committee. From our point of view, this stipulation should be excluded from the law, since unitary enterprises often use new companies to sell state owned property, withdraw assets, and dilute the state owned shares.

Entrepreneurs often encounter such an entry barrier as the necessity to rent premises, as a rule owned by the oblast, municipal entities, or state owned enterprises. It would be feasible to amend Article 19, which regulates the renting of premises, by including stipulations allowing an entrepreneur complying with the contract concluded with the regional or municipal authorities, or a state owned enterprise, to automatically prolong such a contract. It should be also stipulated that the rent might be risen only in accordance with the inflation rates registered by Goskomstat. It would be also feasible to stipulate that base rent rates should be set for a long term (not less than 3 years). At present, the law stipulates that rent contracts concluded for a period exceeding a year should be approved by the authorities.

Item 1 of Article 20 of the law should define the persons, associations, and socially important objects eligible to be granted the indicated assets. The list may be included in this item. It should be prohibited to transfer assets to commercial organizations and individuals.

Item 1 of Article 22 refers to regional law No. 32 OZ of June 7, 1998, as concerns the implementation of the privatization process. Item 5 of this article contains the list of privatization objects. However, the list fails to indicate profitable enterprises, which could bring more revenues to the state as private organizations at the expense of taxes they would pay to the regional budget. This approach limiting the list of enterprises subject to privatization only to "non-liquid" ones does not seem feasible.

It remains unclear, who would receive the profits derived at the expense of the transfer of shares in commercial companies in trust management. Since this property is owned by the state, the profits should be directed to the regional budget. The law also fails to clearly define the recipients and amounts of the compensation. It would be feasible to clarify these issues.

In order to facilitate the transfer of state owned assets in private property, the law may include the requirement to sell state owned blocks of shares in all enterprises where such blocks do not constitute the controlling interest. However, the transformation of unitary enterprises in joint stock companies and their further privatization (excluding the spheres where unitary enterprises should be maintained due to infrastructure needs) should also be effected. The major method of sale of shares (proceeding from the criteria of effectiveness and responsible management of property) should be auctions (direct sales should be allowed only in case the shares can not be sold at an auction). It shall be prohibited to organize auctions involving more than one measurement criterion as regards the determination of the buyer.

The announcements about the sale of shares should be published in mass media and presented on the official Web site not later than 60 days prior to the auction. The labor collective may be granted privileges as concerns options to purchase preferred shares. The law should also guarantee that auction participants, who made the pledge, are granted access to the necessary information on the enterprise's assets (what is stipulated by the law), as well as the data on the debts of the enterprise.

The investment climate in the region is also determined by the transparency of the regional budgetary process. The Novgorod oblast has enacted law No. 659 OD "On the budgetary process in the Novgorod oblast."

Item 3 of Article 1 and Article 3 of this law refer to state territorial extra-budgetary funds. It shall be mentioned that according to the RF Budget code provisions concerning these funds should be determined in the legislation of RF subjects. In the Novgorod oblast this issue had not been elaborated in detail. This term is referred to only in the law on the budgetary process as confirmed by the single reference contained in the "Konsultant" database. The law also fails to indicate if there exist any other extra-budgetary funds except the compulsory medical insurance fund (as defined in regional law No. 171 OZ of February 22, 2001, "On the budget of the Novgorod regional compulsory medical insurance fund for year 2001"). A positive aspect of the law as compared with legislation of many other regions is that the regional Duma discusses the oblast budget, approves the oblast budget, and monitors the administration of the oblast budget. The most important aspect is that the regional Duma has the similar jurisdiction with regard to state territorial extra-budgetary funds.

Article 6 stipulates that the drawing of the regional budget is the exceptional prerogative of the regional administration. From our point of view, it is possible to grant deputies of the regional Duma and heads of municipal entities the right of legislative initiative.

Article 8 refers to regional targeted programs, on which the regional budget is basing. Certain aspects of these programs should be revised. For instance, the regional targeted program “Spiritual, moral, civil, and patriotic education of the youth in 1999 through 2001.” The only reasonable aim set in the program is the “creation and facilitation in every possible way of residential youth associations and teenager clubs engaged in the process of education.” It shall be also mentioned that the program fails to set concrete amounts of budgetary means required in 2001 and refers to the budgetary law for the same year, what certainly does not make the program more clear.

In 2001, about 23 such programs existed, 14 of them were aimed to develop different aspects of the health care. It is unclear, why so much attention was paid to this sphere, while other targeted programs were much less numerous.

Article 10 determines key guidelines of the budgetary and financial policies, which, for instance, include the basic principles of the regional budgetary policy to be pursued in year 2001, and priorities of financing. It remains unclear what authority determines these priorities and the principles of these determination.

Article 11 defines the balance of financial resources as the balance of all revenues and expenditures of the oblast and all economic agents on its territory. This balance is regulated by Article 175 of the RF Budget Code. It seems feasible to include the revenues and expenditures of the state territorial extra-budgetary funds in this balance.

According to Article 12, the regional targeted programs are formed taking into account budgetary requests. However, the article fails to define the entities responsible for the formation of these requests (in accordance with the RF Budget Code, “budgetary organizations form and submit budgetary requests for the next financial year. The requests are subject to approval of the main administrator, or the administrator of budgetary resources”). The article should also be amended to the effect that the deputies of the regional Duma had the right to participate in the approval of regional targeted programs.

Item 3 of Article 12 stipulates that “within the expenditures of the regional budget, there shall be set limits of provision of tax credits for a term exceeding the current fiscal year, but not exceeding a three year period.” It is a good thing that such limits exist. However, the law fails to justify the logic of these figures and de-

termine the authority responsible for the setting of the amounts of tax credits and respective eligibility criteria.

The article also refers to the limits of provision of state guarantees to third parties as concerns domestic borrowing. It is a good thing that such limits exist. However, it remains unclear what economic agents are referred to (since no parameters of eligibility, for instance, tenders with one formal criterion, are indicated). Maybe the regional budget should refrain from assuming obligations it can not meet.

The sources of financing of the deficit of the regional budget comprise loans from crediting organizations. The law should also stipulate the terms of such credits, including the condition that the interest on these credits should not exceed CBR discount rate by more than 10 per cent as is stipulated by the Novgorod regional budget law. In the future, it would be feasible to prohibit the formation of a budget deficit by law.

The article also stipulates that credits and loans should be attracted on terms set in the annual regional budget law. These terms are stipulated in Article 41 of the regional budget law for year 2001. Loans and credits shall bridge temporary cash gaps in town and district budgets. It is important that the law on the budgetary process also allocated these loans only for this concrete goal.

Article 42 of the regional budget law permits the administration to act as the guarantor of obligations of organizations at the expense of funds indicated in Articles 12 and 40 of the regional budget law (as concerns organizations administrating the resources of the regional budget) and the regional budget law in the case the regional Duma approves such guarantees relating to concrete obligations.

In accordance with this article, the guarantees in amount exceeding 0.01 per cent of the total expenditures of the regional budget are extended to the Novgorod State Fund for Support of Small Businesses in the amount of Rub. 30 million until December 31, 2004. No doubt, this stipulation is important, however, it should be fixed in the law on the budgetary process in stead of the annually approved budget law.

In the process of consideration and approval of the regional budget there is included a list of reference materials comprising the structure of the regional public debt and the estimate of budgetary losses for the next fiscal year. For this law, this norm is necessary and progressive.

Item 2 of Article 27 of the law reasonably prohibits the Financial Committee to form and utilize reserve funds.

Article 38 of the law describes the procedure of the sequester of the regional budgetary expenditures. It seems feasible to stipulate that in case budgetary revenues decrease by less than 10 per cent, the budgetary expenditures should be re-

duced proportionally. In this case, it would be feasible to adopt a stipulation protecting certain budgetary expenditures. These expenditures should be reduced in the last turn.

The budgetary expenditures may be blocked in case it was found out that they were misused (the target amount of budget expenditures is reduced in case they were extended to the chief administrator and recipient of budgetary funds for the performance of certain tasks, but these tasks remained unperformed) in accordance with item 4 of Article 39 of the budget law. It is recommended to indicate the authority responsible for the identification of misuse of funds and respective criteria of misuse. The controlling functions should be vested with the regional Audit Chamber, or the regional administration. It shall be mentioned that no Audit Chamber exists in the Novgorod oblast, and it would be feasible to set up such an organization.

It is inadmissible to extend financial aid to town and district budgets in the form of subsidies and subventions aimed to finance certain targeted expenditures. The regional budget law should stipulate concrete items of targeted expenditures and set their limits (Article 40 of this law).

In the case the budgetary loans are not repaid by the certain deadline, the balance of the non-repaid loan should be paid at the expense of financial aid provided by the regional budget. If budgetary loans are not repaid at the expense of the regional budget, the balance should be repaid at the expense of revenues from regulating taxes due to the budgets of towns and districts (Article 4).

The controlling functions of the Novgorod oblast are listed in detail in Article 45 of this law. For instance, the law stipulates that the regional Duma should set up its own controlling structures. Unfortunately, no such structures have been created yet.

However, the regional audit agency, the financial committee, and other agencies exercise financial control on behalf of the regional administration.

It might be feasible to establish a joint structure of financial control (of the Novgorod regional Duma and the regional administration).

Major types of misuse of budgetary funds are listed in detail in Article 47 of this law and may serve as the model for the budgetary legislation of other RF subjects.

Chapter 6.

Political Development of the Novgorod Oblast: Minimizing the Risks

A key factor behind a successful economic development of a country or a territory is political and social stability. The Novgorod oblast presents a good example in this respect.

The region comprises 21 administrative districts, three regional cities. The largest cities are: Novgorod the Great (population exceeds 230 thous.), Borovichi (60 thous.), and Staraya Russa (about 41 thous.).

According to the census conducted in 1989, the ethnic composition of the Novgorod oblast is: Russians – 711.760 (94.7 per cent), Ukrainians 14.435 (1.92 per cent), Belorussian – 7.734 (0.90 per cent). Therefore, Novgorod is a mono-ethnic region.

On November 1, 1991, the RF President appointed Mikhail Prusak, a former people's deputy from Komsomol, as the Head of the administration of the Novgorod oblast. The Governor graduated from the Higher Komsomol School at the Central Committee of Komsomol in Moscow. He was conferred the degree of a history and political science teacher. It is an interesting fact that the lack of special education in the sphere of management did not prevent his success as a regional leader. This circumstance confirmed the popular hypothesis that the Soviet experience was rather a negative asset in the modern market environment. Later In December of 1993, Prusak was elected to the Federation Council (more than 50 per cent of the vote). In December of 1995, he was elected as the Governor of the Novgorod oblast (56.49 per cent of the vote). It is an interesting fact that as the Governor, Prusak was constantly gaining in popular support. In September of 1999, he was reelected as the Governor receiving 91.56 per cent of the vote. It is an illustrative fact that no serious contender was nominated for the election, although, in contradistinction to many other regions, no administrative obstacles for this existed in the Novgorod region. There were also no complaints with regard to the falsification of the election outcome¹⁶. Therefore, it may be asserted that the initial public support of the charismatic Governor had reached proportions unusual for a democracy and became a factor facilitating the implementation of reforms. In a half of regions, heads of administrations appointed by

¹⁶ An indirect evidence that elections were not manipulated is the fact that just several months later G. Burbulis lost the election to the State Duma in spite of the Governor's support. It could not have happened if the Governor manipulated the elections.

B. Yeltsin¹⁷ in 1991 through 1995 have lost their offices. Although the analysis of this electoral phenomena is outside the topic of our study, it shall be nevertheless noted.

The formation of the regional administration was completed in 1992 without triggering a conflict between the “old” (specialists previously holding offices in the regional Soviets and Party committees) and “new” (“democratic”) nomenclature, what was a typical development in many other regions. As a result, representatives of different political forces had to share the power in the region.

Later, some changes were made, however, only at the very top. There were appointed new deputies of the head of the regional administration and some heads of committees. Valery Trofimov, a former people’s deputy of the USSR, a member of the liberal Interregional group of deputies, was appointed as a deputy head of regional administration (later he became the first deputy), while Oleg Ochin (the Chairman of the Novgorod City Soviet) was appointed as the deputy head of administration coordinating the issues related to the social sphere. Such personnel policy allowed to retain and consolidate political stability in the region. M. Prusak implemented the same policies with regard to the appointments of the heads of district administrations (the majority of district leaders kept their offices, there were no conflicts with district Soviets), what strengthened his authority in the view of local elites.

The stability of the personnel policy pursued by the Governor had a positive effect in the future. The first major changes at the top of the administration occurred only in 1997 and early 1998, when V. Trofimov, who successfully organized the work of the administration aimed at the attraction of investment, left his office to start a business. Mikhail Skibar, the former vice-mayor of Novgorod, took the office.

In spite of certain minor disagreements, which at first existed between the regional Soviet and the head of administration, on the whole the relations between the legislature and administration were normal. (In the majority of regions, even those run by the “democrats,” such conflicts could not be prevented). According to the officials of the regional administration, the Governor was ready to cooperate with the regional Soviet. It is also important to note that political parties in the Novgorod oblast were traditionally weak. In this case, it was a positive

¹⁷ In principle, heads of regional administrations should have been elected. However, in 1991 the congress of people’s deputies granted B. Yeltsin emergency powers, including the power to appoint governors. After the new Constitution was adopted in 1993, the new legislation enacted in 1995 through 1996 stipulated that heads of regions should be elected and not appointed.

factor. In 1991 and 1992, the “Democratic Russia” was too weak to force the Governor to take a course against the incorporation of the old elite, while the regional Communist party organization reestablished in 1993 was too weak to organize mass protests against economic reforms. The left opposition lacked a charismatic leader. Both V. Gaidym, the regional Communist leader and N. Bindyugov (the Communist party secretary for ideology) had regularly lost elections even at the peak of discontent (in 1993 to the Federation Council, in 1995 for the Governor’s office). They were supported by even fewer voters than the Communist ticket on the whole. Even such influential figures from the democratic camp as A. Kuznetsov, the representative of the RF President¹⁸ in the region in 1992 through 1993, and O. Ochin, who was elected to the State Duma with the support of the Governor but later opposed him¹⁹, could not compete with Prusak. In fact, since 1996, there has been practically no opposition to the Governor. Only certain decisions of the regional administration and the federal authorities were criticized.

The electoral history of the Novgorod oblast is somewhat different from that of Russia at large. Initially, in 1991, B. Yeltsin had less support in the region than in Russia on the average (46.65 per cent and 57.30 per cent respectively), while N. Ryzhkov was supported by 21.32 per cent of the regional constituents (16.85 in RF). In April of 1993, in the course of the referendum of April 25, 1993, 59.41 per cent of voters expressed their confidence in the President (58.67 per cent in RF) and 52.9 per cent approved the policy pursued by the President (53.04 per cent in RF), i.e. the results were close to the national average. The RF Constitution was supported by 61.37 per cent of Novgorod residents. However, the majority of Novgorod constituents voted for the party of left populist V. Zhirinovskiy in the course of elections of 1993 (LDPR – 29.60 per cent in Novgorod and 22.92 per cent in RF), while the number of voters supporting other parties was close to the national average. The figures registered in the course of elections of 1995 were also close to the all-Russian average (CPRF was the leader with 18.44 per cent of the regional vote as compared with 22.30 per cent in RF; LDPR was the second with 12.41 per cent of the regional vote as compared with 11.18 per cent in RF; NDR supported by the Governor was the third). The results of the first and second rounds of the presidential elections were practically the same as

¹⁸ This office somewhat reminded the post of a political commissar. Although representatives of the President lacked formal powers, they regularly informed the President on the situation in respective regions. In some cases, such reports resulted in dismissal of appointed governors.

¹⁹ O. Ochin lost the next election.

the national average (59.14 per cent and 33.99 per cent respectively). In 1999, Prusak participated in the NDR election campaign. However, the results (except of the fact that in Novgorod NDR managed to pass the 5 per cent barrier) were very close to the national average, although the trend was more clearly pronounced: Yedinstvo was far ahead of Communists (31.55 per cent and 19.5 per cent respectively). Therefore, in the 1990s the population of the Novgorod oblast somewhat “moved” to the right, what in terms of reforms provides a normal background for business activities.

In April of 1994, there were elected the majority of the Novgorod oblast Duma deputies. Since the Duma is rather small (27 deputies), it strengthens the influence of the administration. Anatoly Boitsev has elected as the Chairman of the regional Duma and still holds the office. In 1991, Boitsev, a former Komсомol and Communist party functionary, held the office of Vice-Governor. As the Duma Chairman, he heads a Duma absolutely loyal to the Governor, where few oppositionists have practically no influence. More than a third of elected deputies are heads of districts, while managers of enterprises and employees of the social sphere comprise the rest. This proportion has practically not changed since that time.

In 1996, the first executive and legislative structures of local governments were elected in the districts (according to the regional legislation, the head of a district is elected by popular vote and heads also the local Duma). There were also elected village chairmen. As a result of the elections of 1996, the majority of leaders kept their offices. A. Korsunov, the Novgorod mayor appointed to the post in 1994 (previously he had held the office of a vice-governor), was successfully reelected to the office in 1996 and 2000. In spite of various rumors, it is important that the redistribution conflict (typical in many RF subjects) between the administration of the regional center (as a rule, more wealthy than the rest of the region) and the Governor (who had to defend the common interests, including the interests of depressive districts) did not transform in political struggle.

The Governor has loyally cooperated with the heads (appointed by Moscow) of so called structures of the federal vertical (regional offices of the Interior Ministry, FSB, tax police, GTRK, customs, the President’s regional representative and later the federal inspector). In spite of the practice of horizontal rotation of the personnel of these agencies, Prusak had managed to keep loyal and well known to him Novgorod residents at practically all key positions (except FSB). Although the Governor criticized the concept of federal okrugs, he maintained normal relations with V. Cherkesov, the representative of the RF President in the North West federal okrug. This phenomenon can not be unambiguously evaluat-

ed. On the one hand, the presence in the region of a federal structure independent of the Governor substitutes for the practically absent delimitation of the administration and legislature by creating a “system of checks and balances.” The absence of conflicts between federal structures and the Governor in fact means that local law enforcement officers are the clients of the Governor, who uses them to support friendly businesses and to suppress independent entrepreneurs. This risk exists even in case the official is an honest person. On the other hand, practically no criminal scandals or fights for property²⁰ have broken out in the Novgorod oblast. There were registered no accusations of the Governor or his closest allies. At the same time, the dependence of federal structures on the Governor allows the latter to exclude unfriendly actions on the part of the former and to guarantee that no delays would block large investment projects needing personal monitoring²¹. In the course of informal discussions, officials admit that the single vertical hierarchy headed by the Governor is a rather positive factor, which accounts for many regional achievements. Since the Governor had managed, literally speaking, to form a positive credit history of his business, his authority is perceived as rather a good than an evil.

However, it is important to note that the regional judiciary is independent, what allows to effectively appeal against authorities’ decisions. For instance, in 1996, the Novgorod regional court ruled against resolution of the head of the Novgorod regional administration No. 347 of December 28, 1994, “On the introduction of payment for the use of game resources,” since it was not in compliance with the federal legislation. The regional administration complied with the ruling.

The Governor of the Novgorod oblast has set up constructive relations with the federal government and the RF President. It is important to note that one of the President’s residences (Valdai) is located in the Novgorod region, what facilitated personal contacts between the Governor and the President. At the same time, the Governor avoided any personal remarks while criticizing the govern-

²⁰ Of course, certain negative processes were observed in the Novgorod region. For instance, L. Dyakonov, the head of the administration of the Malovisherovsky district, was arrested in St. Petersburg on bribery charges. However, he was acquitted. In 2000, Ye. Shulan, the director of “Splav” factory was murdered. The investigation is still underway.

²¹ The regional administration appoints the vice-governor personally monitoring the project in case the amount of investment exceeds US \$ 100 thousand.

ment or promoting his exotic initiatives²². It shall be also taken into account that no laws or resolutions adopted in the Novgorod region openly contradict to the federal legislation, Moscow formed a positive image of the Novgorod Governor. In fact, the absence of such serious in the civilized world infringements as unlawful regulation of prices, introduction of internal customs barriers, confiscation of property is seen as a great achievement. At the same time, the Governor has failed to set up relations with the “party of power.” In 1993, he joined the Party of Russian Unity and Consent (PRESS). In 1995, he was among those few who did not join NDR. However, in 1999, when NDR was close to the political collapse, Prusak tried to support it and headed the regional party ticket. At present, the Governor is unable to control the pro-President Yedinaya Rossiya. The federal party leadership supports Ye. Zelenov, who was elected as a State Duma deputy from Novgorod in spite of the Governor’s opposition. However, this conflict may become a positive factor in the situation, where the regional mass media practically does not criticize the regional authorities. On September 25, 2001, Mikhail Prusak was elected as the leader of small and not known even in the region Democratic Party of Russia.

An important factor for the region facilitating the inflow of foreign investment was the fact that M. Prusak was the Chairman of the Federation Council Committee for international relations.

As concerns the further political developments in the region, it shall be mentioned that in order to put in place a feedback system (by definition, the regional authorities would not be able to set up such a system) it would be feasible to enhance the role of the regional mass media. Unfortunately, until now they just inform citizens about the decisions and views of the regional authorities. Mass media and authorities should naturally oppose each other, since the bureaucracy is unable to inform the regional leadership about flaws in the system of governance, it is a function of mass media and the third sector.

²² For more details on the ideas of reorganization of Russia’s constitutional system promoted by M. Prusak, see: <http://prusak.novgorod.ru/prusak.htm>

Chapter 7. The Pskov Oblast: the Story of a Failure

Not long ago, M. Prusak proposed to include the Pskov oblast in the Novgorod region. This suggestion was strongly rejected by the authorities of the neighbor oblast. It is not surprising that the Governor of one of the neighbor regions has all reasons to offer his candidature to Pskov residents as a “Viking.” (The legend is that Novgorod residents had invited Vikings to rule their land as princes asserting that “our land is wide and rich, but it lacks order”). These two regions were in absolutely similar position in the early 1990s, when the market reform was launched. While the Novgorod region had some advantages related to its electronic industry (although later this potential proved useless), the Pskov oblast could derive transit rent at its border with Estonia.

Both Novgorod and Pskov are parts of the North West economic region, and have practically equal advantages in terms of their closeness to European countries. These regions are located between two largest consumer markets of Russia, St. Petersburg and Moscow although in this regard the Novgorod oblast is in a somewhat better position.

The Pskov and Novgorod are neighbors; they have similar climate conditions and therefore equal opportunities to develop agriculture, similar living conditions.

The Novgorod and Pskov oblasts are similar in terms of the size of population and territory (see Table 8.1). The only aspect in the Pskov region is worse than in Novgorod – the demographic situation.

Table 8.1.

Population and territory of the Novgorod and Pskov oblasts

Indicator	Year / date	Unit of measurement	Novgorod oblast	Pskov oblast
Population	As on 01.01.1997	Thous.	739,3	827,1
Territory		Thous. Sq. km.	55,3	55,3
Population density	As on 01.01.1997	Residents per sq. km.	13,4	15,1
Share of urban population	1996	%	70,9	65,3
Natural increase in population	1997	Per 1000	-9,7	-11,9
Number of pensioners	As on 01.01.1997	Per 1000	294,8	302,9

Source: Goskomstat

Both regions are not well endowed with natural resources; therefore, they can not specialize in extracting industries. By the start of reforms, the mechanical engineering was the staple industry both in the Novgorod and Pskov regions. However, it is necessary to note that the Novgorod oblast had also the chemical industry, which was in a more favorable position than mechanical engineering in the early 1990s.

By the start of reforms, the Novgorod and Pskov oblasts were close in terms of indicators of economic development. For instance, in 1990, the amounts of industrial output were practically similar (Rub. 2.5 billion and Rub. 2.4 billion in the Novgorod and Pskov regions respectively). In per capita terms, the Novgorod indicator of industrial output was only 1.165 times higher than in Pskov. Annual rates of growth in industrial output in 1986 through 1990 made 5.1 per cent in the Novgorod oblast and 5.2 per cent in Pskov (i.e. Novgorod had more developed industry, however, Pskov led in terms of the rates of development).

Table 8.2.

Indicator	Year/date	Unit of measurement	Novgorod oblast	Pskov oblast
INDUSTRIAL OUTPUT	2000	Rub. mil.	18909	8306
Agricultural produce	2000	Rub. mil..	4314	5428
Gross regional product	2000	Rub. mil.	16409.7	11548.8
Number of enterprises privatized in this year	2000		49	5
Investment in fixed assets	2000	Rub. mil.	5016	2148
Per capita investment in fixed assets	2000	Rub.	6972	2721
Foreign investment	2000	US \$ thous.	94270	1338
Cash household incomes	2000	Rub. a month	1689.1	1293.1
Balance of profits and losses	2000	Rub. mil.	2826	813
Retail trade turnover	2000	Rub. mil..	221.8	163.5
Paid services to households	2000	Rub. mil.	2017	1536
Credits extended to enterprises, organizations, and individuals	2000	Rub. mil.	1408	910

Source: Goskomstat

Table 8.2. demonstrates the situation existing 10 years later. This picture does not require a special comment. The situation in the Pskov region developed

somewhat differently than in the Novgorod oblast. Its present Governor, Ye. E. Mikhailov is the third to hold the office of the head of the regional administration. He is a member of LDPR and was elected as the Governor in late 1997 (at that time he was a State Duma deputy). Mikhailov replaced V. N. Tumanov, who was appointed to the post in May of 1992 and was viewed as a centrist loyal to the President.

In 1991, A. Dobryakov, a deputy of the local Soviet, was appointed as the head of the regional administration. He was dismissed in May of 1992. He was replaced by **Vladislav Tumanov**, the former vice-mayor of the city of Pskov. The political situation in the region was rather stable in 1992 through 1996. Tumanov maintained the image of a centrist and practical economist. In fact, the regional administration did nothing. On the one hand, this policy did not infringe on the interests of influential pressure groups, on the other hand, it did not facilitate economic growth. In the situation existing in the Pskov oblast, where light mechanical engineering, food, and light industries constituted the industrial base, a Governor actively engaged in the improvement of the investment climate would be very useful, as is confirmed by the example of the neighbor Novgorod oblast, which is practically similar to the Pskov region. (By the way, both the population and elite of the Pskov oblast envy Novgorod). At the same time, Tumanov did not have any significant administrative resource in Moscow, and therefore could not “shake” money out of the federal government. On the other hand, both Tumanov and his administration were not very corrupted (at least, the only accusation of corruption was voiced in the course of the election campaign of 1996 – allegedly, Tumanov was bribed to transfer the investment due to the Pskov region to Novgorod (!) but no evidence was presented). The Tumanov’s administration did not “pressure” businesses, did not introduce administrative barriers, and did not organize the extortion of money for various “extra-budgetary” funds. Initially, when the opposition was rather weak and comprised only former party leaders and some “red directors,” who could not propose any alternative economic policy, Tumanov felt rather comfortably. In 1993, he was rather easily elected to the Federation Council (more than 50 per cent of the vote). However, the continuing economic recession and the difficult to explain electoral phenomenon of Zhirinovskiy (he was especially popular in the region from 1991 till the last Presidential elections; in 1991, he received 12 per cent of the vote, in 1993 LDPR had 40 per cent of the vote, what is the national record figure for LDPR) started to undermine his position. This was demonstrated in the course of the elections of 1996. While Tumanov concentrated his efforts for struggle with a representative of the old party nomenclature V. Pushkarev (former chairman of the regional

Soviet supported by Communists), and V. Sidorenko, the successful director of the agro-firm “Cherskaya,” a young State Duma deputy from LDPR, Ye. Mikhailov became the second participant of the second election round. CPRF and the majority of other candidates unexpectedly supported the young Moscow “Viking.” In spite of the fact that Tumanov won the first round (31 per cent and 20.71 per cent of the vote respectively), Mikhailov decisively won the second round (36.8 per cent and 56.46 per cent respectively).

In this way, Yevgeniy Eduardovich Mikhailov, born in 1963 in the town of Velikiye Luki, was elected as the Governor of the Pskov region. He graduated from a vocational school, served in the army, and later was a construction at a small construction organization. In 1986, he was admitted to the History faculty of the Moscow State University (the department of CPSU history). In 1991, Mikhailov graduated from the University. In 1990, Democratic Russia supported his election as a deputy of the Moscow City Soviet. In 1991, Mikhailov joined LDPR and works as an editor of the party newspapers (“Sokol Zhirinovskogo,” “Liberal,” etc.). In 1993, he won the State Duma elections, mostly due to the huge success of the LDPR ticket (over 40 per cent). However, already in 1995 he was defeated by A. Nevzorov (the regional vote for LDPR fell to 14.5 per cent, and later was even less in the course of the Presidential elections of 1996 – 10.2 per cent. However, LDPR is still supported in the region more than in Russia at large). Mikhailov participated in the Governor election campaign of 1996. His main weapon was promises to bring in the region the “party money,” nationalist rhetoric (based on the fact that Estonia claimed a part of the territory of the region), and promotion of the image of a young energetic specialist who is able to overcome the crisis situation in the region. Zhirinovskiy personally supported Mikhailov and financed his campaign. Another large contributor was MDM bank (some of its shareholders were at that moment close to LDPR). Mikhailov is a nationalist believing in a “firm hand.” He supports state regulation of the economy.

As soon as Mikhailov was elected as the Governor, he let down his key coalition partners – the Communists. Mikhailov refused to appoint V. Pushkarev, former chairman of the regional Soviet, and D. Malyshev, former head of the regional office of the Interior Ministry, to offices promised to them alleging that in this case Moscow would not finance the region. However, initially Mikhailov maintained rather good relations with Communists, promoted their common “popular and patriotic” views, regularly consulted with V. S. Nikitin, the former first secretary of the regional CPSU committee, and the present first secretary of CPRF regional organization. V. L. Vasenkin (an NDR activist) retained his office

of the first vice-governor. Vasenkin was a key (alongside B. Polozov) deputy governor under Tumanov (dismissed in mid-1999). Yu. Demyanenko, the vice-governor for social issues, also retained his post. Soon after the election two groups arrived in the region: Mikhailov's friends from the University (M. Gavunas, Ye. Elfimov, D. Shakhov) and various LDPR functionaries (vice governor V. Kapustyansky, former head of the Orel office of the Interior Ministry, V. Ivchenko, former vice-governor, S. Salonov, etc.). The arrival of "Vikings" from Moscow and the beginning of the massive redistribution of property gave rise to a rather strong opposition to Mikhailov. The appointment of S. Bigovchy, an infamous nationalist, as the Governor's press secretary and the support of openly nationalist newspaper "Pskovsky Kuryer" on the part of the Governor, and his attempts to unify the ideological life in the region on the base of the LDPR ideology were among other factors behind the rise of the opposition. For instance, Mikhailov revoked broadcasting licenses of a number of independent radio stations (for instance, "North West"). **A. Prokofiev**, former Pskov mayor, and "democratic community" represented by local organizations of Yabloko, NDR, DVR, etc. were the first to oppose the Governor. **S. Shadrin**, head of the regional office of the Ministry of The Interior, and V. Fedorov, head of FSDO, accused the Governor and his "right hand" **M. Gavunas** of participation in financial schemes and attempts to use state agencies for commercial purposes. S. F. Shadrin arrested some businessmen and officials close to the Governor and requested that Mikhailov was interrogated. Therefore, when the Governor could persuade the Presidential administration to dismiss Shadrin in August of 1998, he considered this development as a huge success. In late 1999, Mikhailov ordered to prevent his another opponent, the head of the regional FSFO (former FUDN) office V. N. Fedorov, to enter his office. According to Fedorov, it was the result of his refusal to bankrupt alcohol, wine, and vodka factories competing with "Pskovalko." Therefore, at present the Governor's opponents rally around the structures of the Pskov mayor office, and to a lesser degree, the regional prosecutor office.

The elections of the Governor were held on November 12, 2000. Mikhailov was supported by Yedinstvo, and regional mass media, he could dispose of financial resources of unitary enterprises, however, the image of his entourage was against him. The incumbent Governor was challenged by M. Kuznetsov, a deputy of the State Duma, who severely criticized Mikhailov. Kuznetsov conducted an active campaign in the region. Kuznetsov was the most dangerous contender, since he was supported by the huge financial resources of MDM bank and a promotion campaign in mass media. Kuznetsov was well known in the region and

was able to attract a part of the regional elite, still loyal to Mikhailov. Besides, Kuznetsov was not responsible for economic failures and criminalization of the region, he was actively engaged in charity activities.

The Governor managed to persuade the regional Duma to amend the Regional Charter to the effect that the second round of elections was abolished and only one round of elections should be organized. The new election procedure was favorable for the incumbent Governor. 94347 voters out of 723000 regional constituents voted for the Governor (28.06 per cent of the vote). Victor Bibikov, an opposition businessman was second with 15.12 per cent of the vote. Mikhail Kuznetsov was the third with 15.06 per cent of the vote. Vladimir Nikitin (CPRF) was the fourth with 14.48 per cent of the vote. Therefore, in case Mikhailov lost another 3 per cent of the vote, he would have been defeated, since less than one fourth of constituents voted for him. Taking into account the fact that his opponents were ready to team their forces for the second round, it becomes apparent that the Governor lost the public support.

M. Gavunas was dismissed, however, he was replaced by Dmitry Dervoyed, former head of "Pskovprod" and former head of the regional property management committee, who was accused of several crimes.

The Governor pursues the following financial policy: state unitary enterprises are created on the base of regional property, or bankrupt enterprises. Later, all competitors of these enterprises are removed from the market. Although unitary enterprises officially demonstrate rather modest results, they transfer money to the Governor's team via classical intermediary schemes. Until 1998, the tax payments of these enterprises were mainly offset. The following firms (accused of various offences by law enforcement agencies) shall be mentioned in this relation: state unitary enterprise (SUE) Pskovalko, SUE Pskovtorf, SUE Pskov – oblesprom, close joint stock company "Pskovpishcheprom," close joint stock company "Laguna" (two latter are engaged in production of alcoholic beverages). The alcohol producing enterprises of the "SUE Empire" are often involved in scandals related to unlawful utilization of confiscated property, fraudulent exports, inferior quality of their products in comparison with similar goods produced in St. Petersburg or Novgorod. In 1999, these enterprises paid children allowances in kind (vodka "Skobar"). "Pskovalko," which was assisted to become the monopolist on the market of alcoholic beverages, has a special importance (other enterprises related to the administration also are SUEs). Alcohol-

ic beverages are sold at low prices, therefore, according to the statistical data, the wholesale sales of alcoholic beverages in Pskov increased 300 times²³.

The classical “privatization scheme a la Pskov” is organized as follows. The assets of an enterprise, which has debts to the regional budget, are withdrawn (in accordance with the amount of the debt). On the base of these assets, a SUE is created. Further, it is transformed in a joint stock company, where the state owns the controlling interest (51 per cent). Later, the assets are transferred to a close joint stock company, or the company issues new shares, thus avoiding the enforcement of creditors’ claims. The SUE Pskovalko mentioned above was created in accordance with this scheme.

Since recently, **V. V. Blank**, a vice-governor, becomes more and more influential figure in the Governor’s team. V. Blank left Moscow, where he was accused of tax dodging amounting to Rub. 2.8 million, for Pskov. **V. Shakhov**, the head of the Governor’s administrative office, also is an influential figure. G. Podznoyev (at present, a deputy of the regional Duma), and, since recently, **I. Dines**, a regional Duma deputy from Yedinstvo, a representative of “Generation of Freedom” movement, the Governor’s classmate in the University, are also figures from the Governor’s inner circle.

The regional Duma. Elected in 2002. Comprises 27 deputies. The chairman – **Yuri Shmatov**, who is close to CPRF and loyal to the Governor. The majority of deputies are also loyal to the Governor.

Mikhail Khoronen, former vice-mayor, was elected as the Pskov mayor in March of 2000 (over 71 per cent of the vote in the second round). His chief opponent, V. Yevdokimenkov, the director of Pskovkabel plant, supported by the Governor, could receive only 20 per cent of the vote. A. Prokofiev, former Pskov mayor, had 14.4 per cent of the vote in the first round of election and failed to participate in the second round (Yevdokimenkov received 14.64 per cent and Khronen – 36 per cent of the vote in the first round). The defeat of Prokofiev was expected, since he had no team behind him (in 1996, he was also opposed by his deputy Ivanov), and his excessive involvement in public and political projects. In many aspects, Khoronen pursued the same policies as his predecessor. He defended Pskov interests in the course of the redistribution conflict with the oblast. Khronen, who initially maintained political neutrality, is becoming more and more critical of the Governor.

²³ Kantor Yu. Teatr dramy imeni Zhirinovskogo (The Drama Theater Named after Zhirinovskiy) // *Novoye vremya*. – 1997, No. 45, pp. 12 – 13.

The Pskov electorate demonstrates the stable anti-reform attitude, which was only slightly dented in the course of the last Presidential elections in 2000. (Putin won rather easily with 70.3 per cent, Zyuganov received only 25.65 per cent of the vote, almost two times less than in 1996). In 1993, 33.9 per cent of Pskov constituents voted for Zhirinovskiy, i.e. almost all those who voted for candidates promoting the state interference in the economy in 1991 (20.6 per cent of all registered voters). At that time, the radical left opposition was still weak after it was defeated by democratic forces in the late 1980s – early 1990s. In Pskov, Communists and APR together received only 10.1 per cent of the vote (6.1 per cent of all registered voters). In 1995, Communists, LDPR, and Agrarian Party were the leaders of the parliamentary elections. In 1996, Zyuganov won in the second round (48.1 per cent and 45.2 per cent for Yeltsin respectively). In 1999, as before, all liberal parties suffered a shattering defeat. In terms of party tickets, Yedinstvo won with 38.28 per cent of the vote. CPRF received 23.46 per cent, Zhirinovskiy bloc – 6.98 per cent, OVR – 5.13 per cent, SPS – 4.97 per cent, Yabloko – 3.24 per cent.

As concerns legislative measures aimed at the attraction of investment in the region, the Pskov oblast was late by several years as compared with the Novgorod region. Only in March of 1998, the Pskov oblast adopted the regional law “On attraction of investment in the economy of the Pskov oblast.” In accordance with the law, domestic and foreign investors shall have equal rights and equal access to legal protection. The regional administration and the heads of town and district administrations vested with respective powers are guarantors of investors’ rights. For the same purpose, pledge investment funds are established at the regional and municipal levels. The law permits to set up free economic zones in order to enhance the investment attractiveness of the region. Investors may be granted tax benefits related to taxes due to the territorial budget. As concerns the profit tax (with regard to the regional share in this tax) the benefit for investors is set at 50 per cent of its rate and granted for three years. New law replaced the law referred to above (law No. 146 OZ of July 26, 2001, “On state support of investment activities in the Pskov oblast.”). This law is primarily based on the respective Novgorod legislation.

Many documents adopted by the regional authorities in order to stimulate investment were of inferior quality. For instance, resolution of the Pskov City Duma No. 201 of May 28, 1997, “On the procedure governing the granting of privileges related to rent payments by citizens, enterprises, and organizations” was aimed to determine benefit eligibility criteria with regard to rent payments of enterprises. The aim is set wrongly. Item 1.10.2 stipulates that “changes in the

amount of rent payments for non-residential premises occupied by enterprises and organizations are effected by resolutions of the city administration, which shall be in force since the date of publication. However, the financial standing of enterprises and organizations and the state of the city budget shall be taken into account.” I.e., even you are eligible for rent benefits, an official may “take into account the state of the city budget” and reject the respective application, or grant the benefit in case you “stimulate” this official. The eligibility criteria are extremely vague. For instance, item 1.8: “Organizations of all forms of ownership engaged in the rendering of social and psychological assistance to the population.” This criterion may be applied to any entity. However, even in the case we refer to the eligibility criteria for enterprises as stipulated in item 1: “those utilizing own or borrowed funds for implementation of concrete investment projects at newly commissioned premises” the enterprise still shall wait for the expert evaluation by the expert council under the administration. (By the way, this evaluation is not required for “social and psychological assistance”).

It is possible that the Pskov authorities put their hopes on the federal targeted “Program of social and economic development of the Pskov oblast in 1996 through 1998” which still remains in force. By the way, this program was supported by RF government resolutions extending the financing until year 2001. The program is a classic example of “fixing the holes” attitude: the federal financing was allocated for the reconstruction of a concrete village sewage system, construction of additional premises in a concrete school, etc. It was planned to spend more than Rub. 1 trillion for such purposes. However, the oblast fails to demonstrate any results of its implementation associated with the economic development of the region. It shall be noted that the Novgorod regional authorities are displeased with such documents, since they are considered as a “discouraging” factor (the logic is that if you do not work and live in poverty, the federal government will provide necessary aid). Governor Mikhailov does not even attempt to mask this attitude: *“What are the revenues of the federal budget? Oil and natural gas sales, - says Mikhailov. Therefore, the Pskov oblast is equally entitled its fair share of these revenues. Therefore, we are not going to decrease our dependency on the federal budget.”*²⁴

It may be referred to the evaluation given by S. N. Samoïlov, former head of the territorial department of the Presidential administration, to the present head of the Pskov regional administration: “The Governor sincerely wants to govern the region. However, the objective conditions for this are nearly lacking. The region

²⁴ www.indem.ru

has its elite, this elite has its pluses and minuses, but it must not be ignored. At the same time, Yevgeniy Mikhailov has kind of fallen from above and as yet failed to form a serious team. Moreover, the population begins to think that he is not independent in his decision making.” And from another interview: “there are regions, where the Governor forms the team only on approval of the party regional committee (I mean CPRF): people have to wait for approval from the CPRF bureau, or its first secretary... These facts are also somewhat typical for the Pskov region.”

The economic failures of the Pskov region may be generalized in institutional terms:

- Stable anti-reformist electorate;
- Lack of radical reforms in the early 1990s;
- Weakness of the regional elite and its disunity until 1996;
- Continuing conflict between the Governor, the Pskov mayor and the regional offices of federal structures, hence, political instability;
- Scandalous reputation of the Governor, after the elections of 2000, his low legitimacy (Mikhailov was elected by the smallest percentage among all governors elected in 2000 and 2001);
- Focus on the policy aimed to redistribute property in stead of create new property;
- Late and unsound entry of the region on the investment attraction market.

Conclusion

Foreign investors are afraid of political and economic instability in the country. The rapid change of governments, the crisis of August 17, 1998, poorly elaborated laws in the area of external economic activities, tax burden, and other factors make Western business persons to delay investment in Russia and direct investment flows in regions with more predictable policies and economies (for instance, countries of Central and Eastern Europe).

The Novgorod economy still attracts investment from abroad. No doubt, that the Novgorod authorities account for the fact that this process was not stopped and continues. They created an attractive investment climate in the region. Unfortunately, this effort to implement further market reforms and attract new investment, and create a favorable business environment not always please the federal authorities.

While the local legislation grants various preferences to external investors and local authorities provide any assistance to investors, many unresolved problems still exist at the federal level, which sometimes make the regional effort come to naught, while investment in the region mean first of all new jobs and tax revenues.

In the last few years, domestic and foreign experts working in Russia have unanimously evaluated the Novgorod oblast as a region with a most favorable investment climate.

The major advantages of the Novgorod economic policy are political stability, guaranteed maintenance of starting conditions for investment projects, granting of privileges to developing enterprises, granting of equal rights to all strategic partners, simplification of administrative procedures.

All these advantages were incorporated in the Novgorod legislation, which has been developing since 1992 in the direction of systematic improvement of stipulations of the federal normative acts as allowed by the jurisdiction of the regional authorities.

According to the World Bank, domestic and foreign experts working in Russia (the international consulting firm McKinsey, auditing and consulting group of the Ekspert magazine, etc.), exactly those factors were decisive in the process of attraction of foreign capital and rendered the region attractive for investors.

The Novgorod oblast is a rare example of successful economic policy pursued by regional authorities. It has managed to attract more foreign direct investment in per capita terms than the overwhelming majority of Russia's re-

gions, including its neighbor St. Petersburg. The sources of success is the simplification of administrative procedures, procedures regulating land use, and tax benefits granted to investors.

As a result of such policy, since 1997 the region has generated economic growth, while highly efficient companies with foreign investment account for more than half of its industrial output (McKinsey report "Russia's economy: growth is possible").

The major factor facilitating the recovery of the Russia's economy at large, and of each its region, is the inflow of capital, i.e. investment. The inflow of capital in industries waiting for investment to recover growth of production, transition from a prolonged decline to stable growth is the most important factor facilitating the overcoming of the economic crisis in the country at large and all its regions. In case the country fails to find out efficient sources of investment in the sphere of production, the transition to sustainable growth becomes impossible.

The investment decline, of much greater scope than the slump in production has not been overcome. The share of accumulation in the national income decreased more than twofold as compared with figures registered in the 1980s. However, it shall be taken into account that the national income also shrank twofold, and therefore, investment in production declined almost five times and is now insufficient not only for extended, but also simple reproduction of fixed assets in industry, agriculture, transport. The level of investment in fixed assets does not compensate for their deterioration and obsolescence, mortality rates, wear and tear. As a result, the declining production potential, shrinking production capacities do not allow to increase the volumes of output, not to mention idle capacities, while scientific and technological progress and market requirements determine the necessity to implement progressive changes in the structure of fixed assets. The so much needed restructuring of enterprises after their privatization will be practically impossible without massive investment inflows.

In the process of transition to market economy, the state federal budget loses its status of the primary source of investment in the industrial and social spheres, it shall be complimented with investment from regional and local budgets, budgets of enterprises, entrepreneurs. However, the availability and equality of these sources do not settle the problem of investment, since these sources too small to meet all requirements set by the economy, at the same time, these sources are not interested to invest in the real sector of the econo-

my. Commercial banks are also too cautious to make direct investment in production.

Russia needs both strategic and portfolio investors making investment in shares of manufacturing enterprises in order to rebuild its economy. Russia has internal resources necessary for investment. It is no secret that according to many experts billions of dollars flow out of the country annually and become Russian investment in foreign economies. In case this outflow is stopped, the amount of domestic investment would rise significantly.

In this situation, various foreign investments become the primary source of investment resources.

Foreign direct investment is especially effective catalyst of growth, since they bring not only capitals, but also new technologies, efficient management and marketing methods. The essence of economic development is the rapid and efficient adoption of best international practices. Foreign direct investment facilitates this process and results in general economic growth. At least, these investments improve the efficiency and educational level of labor resources.

The Novgorod experience is an evidence that even in the complicated and even frightening for many potential investors Russian economic and political situation there are possibilities to attract significant amounts of real investment capital to be invested in Russia. The analysis of the experience of the Novgorod and Pskov oblasts clearly reveals that important factors are both the economic policy pursued by regional authorities and the political components related to the stability of power, occurrence / absence of conflicts between different levels of government, ideological / pragmatic orientation of the authorities, occurrence / absence of infringements on the ownership rights.

The intensification of regional investment policies and enhancement of the role played by regions in attraction of foreign investment reflect the objective trend in the current development of the Russian economy. The new motto is that regions are the locomotives able to pull the Russia's economy out of depression, while investment is the fuel for these locomotives.

The difficulties encountered in the process of attraction of foreign investment in the Russia's economy at the federal level negatively affect regional investment policies. However, at the regional level, these policies may be more flexible and adaptable to requests, terms, and requirements set by foreign investors. The extent of independence Russia's regions acquired in the process of democratization and economic liberalization of the country allow them to elaborate and implement independent legislative initiatives facilitating the inflow of foreign capital in the region.

Regional administrations may more easily contact potential investors, offer concrete investment projects, persuade to invest in regional objects. Of course, a clear, well elaborated strategy, initiative, insistence to surmount the difficulties are needed in order to pursue such policy. In this case, the success is possible and real. This is the conclusion derived from the Novgorod experience of long and thorough effort of attraction of foreign investment.

Part 2.

Systemic Competitiveness in Canadian Regional Economic Development Agencies and Programs

Chapter 1

Explanation of the Systemic Competitiveness Model

The systemic competitiveness model has been used in this study as a framework to illustrate Canada's regional economic development agencies/programs. The model has been developed with the purpose of showing three vital ingredients, which were regarded as being vital to the success and acceptance (of the programs by the local business landscape):

1. **Complimentary linkages among the 3 levels of government (i.e. National, Regional and Local/Micro):** reducing overlap and bureaucracy, and increasing the efficiency and effectiveness of administering the initiatives at the local/micro level
2. **Transparency of the program, of the various initiatives and the administration of these initiatives at all three levels of government:** This component has been identified by the Department of Industry, as being vital in the acceptance of the businesses and hence building trust among firms and local governments/administering agencies.
3. **Horizontal and vertical integration among the various components at all four levels of the framework:** -The strongest characteristic prescribed by the model as a solidifying base for increasing the effectiveness, of the local economic development initiatives and tools at both regional and local levels.

The following descriptions accompanying the model itself will elaborate on the various components and will attempt to indicate the three vital ingredients. It is important to notice that the top two levels in the model (Meta and National

Levels) are the same for all four of the models (FedNor, Western Diversification, ACOA and the KW Research Triangle). However, all four economic development ‘initiatives’ illustrate different approaches to economic development. The orientation of the economic development initiatives described in by the four models can be summarized in the following table:

Region Served	Name of Program	Orientation of Economic Dev. Initiatives
Northern Ontario	FedNor	<ul style="list-style-type: none"> • Mainly geared at local economic development through small business counseling and provision of capacity building services for small business • Network Formation • Emphasis on disadvantaged population: Youth, Women, Aboriginals, Francophone
Western Provinces: (British Columbia, Alberta, Saskatchewan and anitoba)	Western Diversification (WD)	<ul style="list-style-type: none"> • Most of the expenditures are geared toward capital projects and investments into the infrastructure, and innovation centers • Emphasis on partnerships among public/private sector and the local institutions of higher learning • Major projects include telehealth, fuel cell technology and geomatics • Further regional specialization (i.e. BC obtained a Multimedia Innovation center and Alberta a Petrochemical Institute – due to the proximity and size of the local market • Network Formation
Atlantic Provinces: New Foundland New Brunswick Nova Scotia and Prince Edward Island	ACOA	<ul style="list-style-type: none"> • Special emphasis is placed on the provision of financial support to the region’s small and medium sized businesses • Most capital projects are geared at community development initiatives mainly connectivity, access to information and hence the market place
Southern Ontario: Kitchener, Waterloo and Guelph	Canadian Technology Triangle (CTT)	<ul style="list-style-type: none"> • Emphasis on the provision of both debt and equity capital through the presence of venture capital firms and a proactive charter bank structure • High tech sector is heavily marketed complimented by the presence of three universities and numerous technical colleges.

Chapter 2.0 Methodology

The following sub-sections will describe FedNor and Western diversification's program and initiatives by tracing the interaction of the components among the first two levels (conceptual and national) and the other two (i.e. regional and local) levels of the systemic competitiveness model. The purpose of this section is to explain and/or elaborate on the significance of the individual components as well as illustrate the flow of implementing the concepts thus, portraying the three vital ingredients described in precedent sections of this report.

2.1 Logistical Explanation: A Legend to Follow

Each model is broken down evenly into 4 levels. The individual components in the first two levels are labeled with capital case letters (A-E) and miniscule letters (a-d). It is important to note that these two levels remain constant throughout the four models for the four regions examined. This is an important characteristic exemplifying a cohesive vision on the approaches (i.e. logistical and policy consistency) to local economic development throughout the country. The components of the lower two levels are labeled with roman numerals (I-IV) and Arabic numerals (1-3). The variation occurs at the lower two levels according to the specific needs and/or industrial and economic specialization of the region examined. The following table is a list of the individual components (the constants) for the top two levels. The components of the lower two levels, will be examined individually under the following subsections specific to the region.

Legend for Upper Levels in Framework

Level of Analysis	Legend	Individual Component
Conceptual Level	A	Diversification of the local economy increasing competitiveness
	B	Enhancing the Investment and Entrepreneurial climate
	C	Building local community and economic capacity through the enactment of local organizations

Level of Analysis	Legend	Individual Component
	D	Reducing the out migration of youth and skilled labor
	E	Increasing the flow of trust among firms and government
National Level	a	Connectivity
	b	Innovation
	c	Policies and Acts
	d	Business Support and Development

CHAPTER 3.0

FedNor: Northern Ontario's Regional Economic Development Agency

This section will begin by providing a brief synopsis of the agency including its: 1) evolution, 2) budget and 3) orientation. The following subsection will examine the individual components.

3.1 Introduction

Launched in 1987, the Federal Economic Development Initiative for Northern Ontario has experienced steady growth in the development of new programs, new partners and enhanced funding for communities across the North.

Today, FedNor invests more than \$45 million a year directly into programs and services, which bring economic benefit to northern communities. An additional \$18 million is flowed through the provincial network of Community Futures Development Corporations, strategically located throughout Northern and rural southern Ontario.

On a daily basis, FedNor communicates with a diverse client base, including stakeholders and community representatives from the tourism, transportation, telecommunications and resource-based industry sectors, to small business, health, research and educational institutions, as well as business associations and professional groups. FedNor is also committed to helping traditionally under-represented populations (ie: Aboriginals, Francophone, women and youth) participate more fully in economic development.

3.2 Regional and Local Analysis

1. Connectedness

As stated on the FedNor web site, the agency "is committed to working with Northern communities to develop and enhance the telecommunications infrastructure and networks throughout the North in an effort to increase opportunities for local business, build high speed data linkages to rural areas and to facilitate community economic development". The purpose of this initiative is to improve access to information, technology, by utilizing the Internet medium.

Some of the key projects that FedNor is currently involved in include:

FRAMEWORK OF SYSTEMIC COMPETITIVENESS - FEDNOR

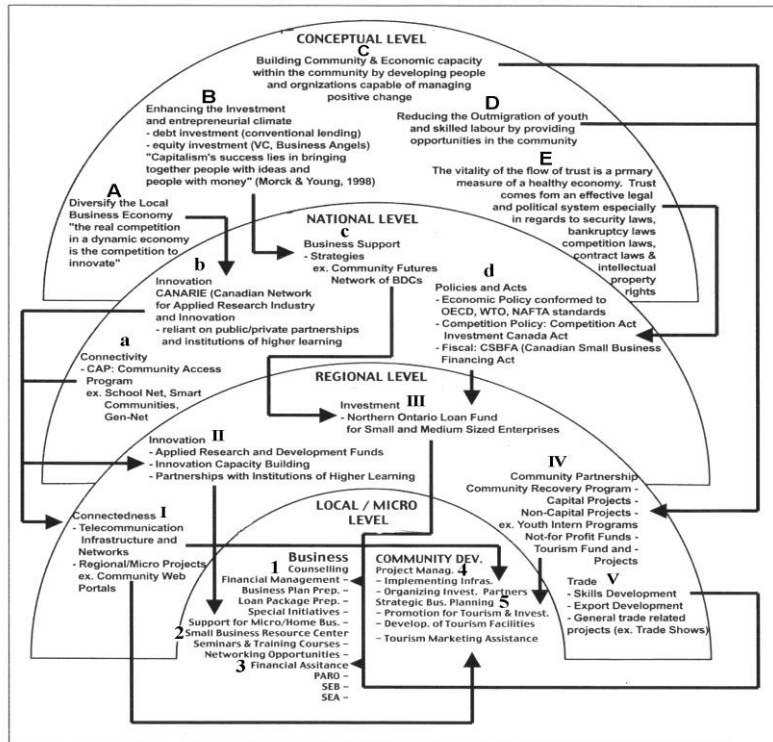


Fig. 1

- **Telecommunication Infrastructure:** initiative is intended to build a lifeline to rural areas, ensuring integrated telecommunications, high speed data transmission, which will facilitate information technology and telecommunications applications such as e-commerce. The eligible projects (both capital and non-capital) are co-funded by FedNor (usually in partnership with National projects CAP [refer to 'a' legend in the second level], and private sponsorship or a telecommunication provider). The funding is geared for: the purchase and installation of integrated telecommunication systems, satellite systems, high speed data transmission, and the hard-

ware and software associated with establishing these systems; feasibility studies; arms-length consultants/engineering training and skills development to utilize the infrastructure

- **Telecommunication Networks:** eligible activities may include both capital and non-capital costs and may include costs such as: the establishment and operation of a not-for profit organization; feasibility studies, arms-length consultants/engineering, training and skills development, or any other activities that facilitate the establishment and development of organizational and administrative networks, which support telecommunication infrastructure development

II. Innovation

FedNor is committed to supporting technological innovation, research and development, and the commercialization of new products and processes in Northern Ontario. By working with various community stakeholders FedNor will identify significant opportunities that will link traditional resource industries to a more knowledge-based product and service development. Some of the major projects FedNor is currently involved in include:

- **Research and Development:** FedNor funds projects for both non-for-profit organizations, local economic development departments and community groups as well as Small and medium sized enterprises (SMEs) that are willing to invest into R&D for the purpose of becoming more competitive and innovative, increasing market exposure, and creating local jobs within FedNor boundaries. FedNor's contributions will normally not exceed 50% of eligible costs to a maximum contribution of \$500,000 and is mainly to cover costs associated with consulting services, hardware software and skill development [the component is tied in with '1', '4' and '5' at the local level and is in cohesion with 'A' at the conceptual level and 'a' and 'b' at the national level]. This is an functional example of horizontal and vertical integration at all levels of the framework.

III. Community Partnership

FedNor is committed to supporting community-based economic development efforts that create employment and stimulate growth in the North through

partnerships with community groups and not-for-profit organizations. A short list of these projects include:

- **Youth:** Youth retention programs, summer job creation and skill development as well as entrepreneurial development are some of the functions funded by FedNor and administered at the local level by economic development organizations, community groups, first nation committees, and non-for-profit associations.
- **Tourism:** tightly joined with the subsequent project type (community recovery) tourism projects divert between capital and non-capital projects which include community web portals (for market exposure), trade shows for local merchants, sponsorship of local fairs and cultural events
- **Community Recovery:** This fund was designed to provide special assistance to Northern Ontario communities that have been adversely affected by sudden or severe downturns in their local economy. This funding will support the development and implementation of recovery strategies including economic analysis, strategic planning, feasibility studies

VI. Trade

FedNor is committed to enhancing the competitiveness of small and medium-sized businesses in the North by helping them develop and expand their export and trading activities including:

- **Export:** FedNor's role is to encourage the application of electronic commerce and export-orientation as ways for Northern Ontario business to enter world markets, to assist business and industry associations/networks and SMEs in developing and expanding export programs. Projects include: the establishment and maintenance of development networks, feasibility studies, or any other activities in support of trade-related small and medium sized businesses and entrepreneurship and grants are administered to local economic organizations, first nations and non-for-profit organizations (ex. Community Futures Program). This component ties in 'III' and 'V' at the regional level and '1' and '3' at the local level.

The following chart summarizes consistency and interaction of the components illustrated in the arrows in figure 1.

Summary Chart: Consistency and Interaction in FedNor

Conceptual Level	National Level	Regional Level	Local Level
A	B a	II, I	2 4, 5
B	c	III	1, 3
C		IV	5
D		IV	5
E	d	III	1,3

Chapter 4.

Western Diversification: Regional Economic Development Agency

This section will begin by providing a brief synopsis of the agency including its evolution, budget and current interests/specification. The following subsection will examine the individual components.

4.1 Introduction

The Department of Western Economic Diversification (WD) was established by the Western economic Diversification Act (S.C. 1988, c. 17) on June 28, 1988. Some of the programs now under the Department's mandate were transferred from the Department of Regional Industrial Expansion. The Department is responsible for federal economic development activities in Western Canada and works in partnership with provinces, business, industry associations and communities to stimulate and diversify the economy in the West. It is important to note that WD's strategy is the incorporation economic initiatives with community development projects.

In light of the above, WD administers 5 major initiatives to develop and diversify the western economy including: a special initiative to assist Francophone Economic Development (a minority group in Western Canada), Innovation Projects, Investment initiatives, the Infrastructure WD Program, and the Western Canada Business Service Network.

4.2 Regional and Local Analysis

1. Francophone Economic Development Initiative

To further enhance Francophone economic development, WD has brought Francophone Economic Development Organizations (FEDOs) into the Western Canada Business Development Network (WCBSN). FEDOs operate in each of the four western provinces and have a mandate for Francophone economic development. Some of the major tools under this initiative include:

- **Access to Capital:** WD is providing access to capital through a loan loss reserve fund in each province. WD and the francophone economic development organizations already have or are in the

process of arranging for a financial institution to provide loans to the community for business development. The loan loss reserve is set up in each region to allow an additional leveraging of funds up to \$2 million through a financial institution in the region. This tool is horizontally integrated with 'III', and '1', '2', '3' at the local level (see Figure 2).

FRAMEWORK OF SYSTEMIC COMPETITIVENESS – WESTERN DIVERSIFICATION

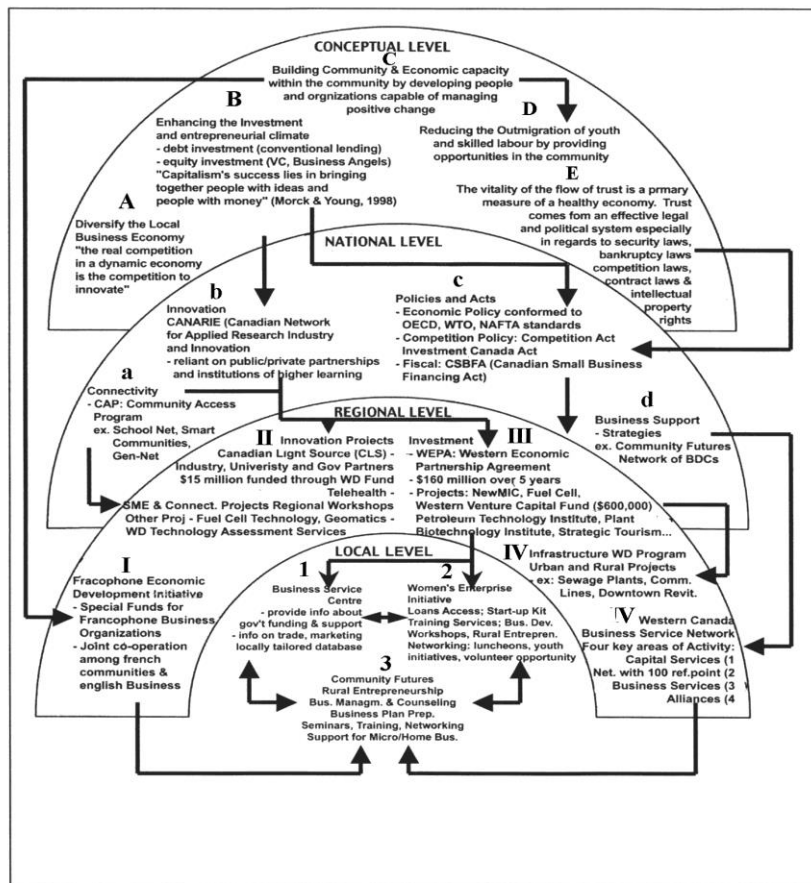


Fig. 2

- **Regional and Pan Western Special Initiatives Funds:** As part of the FEDOs' strategy, special initiatives funding at the regional and at the Pan Western levels have been made available to support activities and projects which will have an economic impact on the Francophone community. The Pan Western initiatives will be projects that will be agreed upon by all four organizations and managed on a rotating basis across the West. An example of Pan Western initiative may be a project such as "Le corridor touristique de l'ouest." The tourism sector is identified as an area of economic opportunity and growth for the French speaking community. This tool integrates some of the projects under initiative 'IV' at the regional level.
- **Entrepreneurship:** The FEDOs have actively supported the entrepreneurial spirit in western francophone communities by providing resources and networks to advance small and medium size enterprises across the West. The FEDOs have the mandate to provide business planning, business counseling services and information on government programs. Some of the various services include:
 - Small business information for francophone entrepreneurs;
 - Referral to government programs;
 - Information sessions, workshops, and exhibits to strengthen the skills of francophone entrepreneurs and to allow them to explore business opportunities;
 - Business management skill development for francophone businesses, including marketing and bookkeeping;
 - Business counseling and access to financing for business development and expansion.

The initiative to foster endogenous growth, rather than relying on attracting large multinational corporations is consistent with almost every conceptual component at the first and second level in the systemic competitiveness framework. However, it is important to note that the provision of the above business counseling & development services are implemented and administered at the local level. Most directly these tools are integrated in with component 'V' at the regional level and '1', '2', '3' at the micro level.

II. Innovation Projects

The WD agency assesses innovation as one of the most important elements in developing regional economies, capitalizing on new opportunities, and accessing global markets. Western Canada has generally high levels of productivity in some resource-based industries and the agencies strategy is to strengthen its capacity to exploit knowledge-based opportunities for economic growth. Some of the already implemented projects include:

- **Canadian Light Source Facility:** The \$173.5 million CLS facility will be the result of long-term collaboration between all three levels of government, universities and the private sector. WD will fund \$5 million to the project through WEPA (refer to 'III' component) and will administer \$15 million received from the federal government through the CANARIE program (refer to 'b' at the national level).
- **Telehealth:** WD sees an opportunity for innovation to help provide health solutions through the application of information technologies. Technological advancements are having a profound impact on the marketplace. Western Canadian small- and medium-sized enterprises (SME) can play a significant role in developing technological solutions. Currently, the WD is in the process of sponsoring workshops, conferences and other networking initiatives to assess the current need and begin the implementation phase by funding R&D in the field. Once again this initiative has direct links to 'A' and B components at the national level, as well as horizontal integration with the 'III' component at the regional level and '1', '2', '3' at the local level

III. Investment (WEPA)

The Western Economic Partnership Agreements (WEPAs) promote economic growth and employment opportunities in Western Canada. These federal-provincial agreements focus on strategic areas of mutual interest, and will lead to an investment of up to \$160 million in federal and provincial contributions in Western Canada over five years. Projects already implemented include:

- **NewMIC** is a groundbreaking collaboration between industry, academia and government that focuses on the research, development and commercialization of cutting-edge new media technology. It is an interdisciplinary centre with corporate sponsors, and institutes of

higher education - Simon Fraser University, TechBC, University of British Columbia and University of Victoria. The centre is located in British Columbia.

- **Petroleum Technology Research Center (PTRC):** The \$11 million, Regina-based center employs 50 scientists and graduate students who work on environmentally and economically sustainable ways of enhancing the production and value of oil resources in Saskatchewan, the rest of Canada and throughout the world. By bringing together researchers from the Saskatchewan Research Council and the University of Regina under one roof, the PTRC will gain synergy and efficiency in completing research.
- **Plant Biotechnology Institute:** a top agricultural research facility in Saskatoon, received funding under the WEPA for a multi-million dollar expansion announced in June, 2000. The \$15.4 million extension will house incubation facilities for start-up companies including laboratories, offices, analytical services and controlled environmental growth rooms.

The above examples of projects under WD investment program clearly illustrate WD tendency to invest into innovation and R&D, as well as public-private partnerships as a strategy to collect the necessary funds. Also, it is important to note the location (underlined) of the projects. WD intentionally fosters the growth of these research centers based on the strength of the local industry (ex. BC – film industry, Saskatchewan – agriculture, Alberta – Petroleum and gas extraction), thus fostering the demand for the local job market.

IV. Infrastructure Program

Some of the program's initiatives include: local transportation, cultural and recreational facilities, infrastructure supporting tourism, rural and remote telecommunications, high-speed Internet access for local public institutions and affordable housing. The division of funding is equally distributed among urban and rural areas as well as areas occupied by minority groups (i.e. francophone, native). These initiatives, clearly demonstrate WD's affirmation that economic development must be accompanied with integrated community development efforts.

V. Western Canada Business Service Network

With a delivery network of over 90 points of service across Western Canada, small and medium-sized businesses in most rural and urban centers can easily access WD's and a range of other business services. This Western Canada business service network includes all Canada Business Service Centers, Community Futures Development Corporations, Women's Enterprise Initiative offices, and WD regional offices in Western Canada. Other stakeholders and partners delivering programs and services to small businesses in the West include federal departments, provincial and municipal governments and industry associations. Four key areas of activity include:

- **Capital Services** - Helping small businesses in "new economy" sectors access WD-sponsored loan programs; providing information on alternative sources of financing for the following industry sectors: biotechnology; information technology and telecommunications; knowledge-based industries; agricultural value-added processing; tourism; urban and aboriginal micro-businesses. This tool coincides with component 'B', 'c', 'III' and '1','2','3' at all levels of the framework.
- **Business service network** - Creating a "single-window" source of information for small businesses in the West. The network includes Community Futures Development Corporations, Women's Enterprise Initiative offices, Canada Business Service Centers, and WD offices throughout Western Canada. This tool is integrated with components 'B' and 'C' from the first level of the framework.
- **Alliances:** Helping established industry alliances to enhance the competitiveness and growth of industries vital to Western Canada, promoting community economic development in rural areas
- **Business Service Centers:** help path finding information about government programs - federal and provincial - in support of small and medium-sized businesses, as well as providing information on trade, market opportunities, the economy and other material of interest to small and medium-sized businesses.

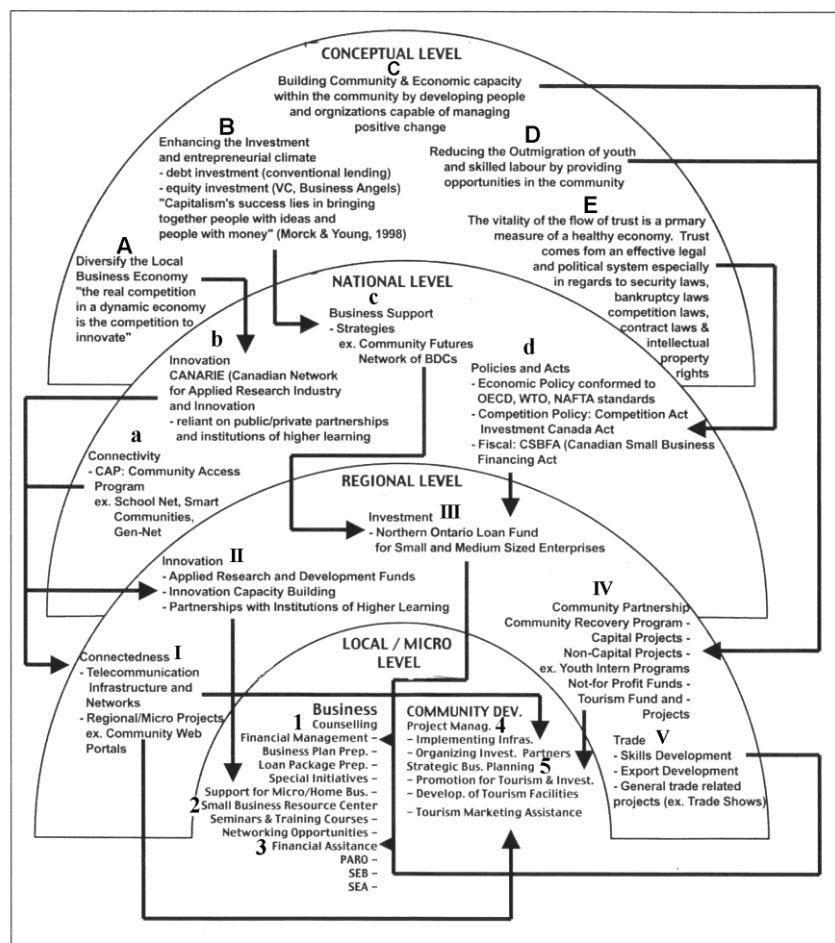
Summary Chart: Consistency and Interaction in WD

Conceptual Level	National Level	Regional Level	Local Level
A	b	II, III	1, 2, 3
B	a,c	III, IV	1,2,3
C	c	III IV	1, 2,3
D	c	III IV	1, 2, 3
E	c	III IV	1,2,3

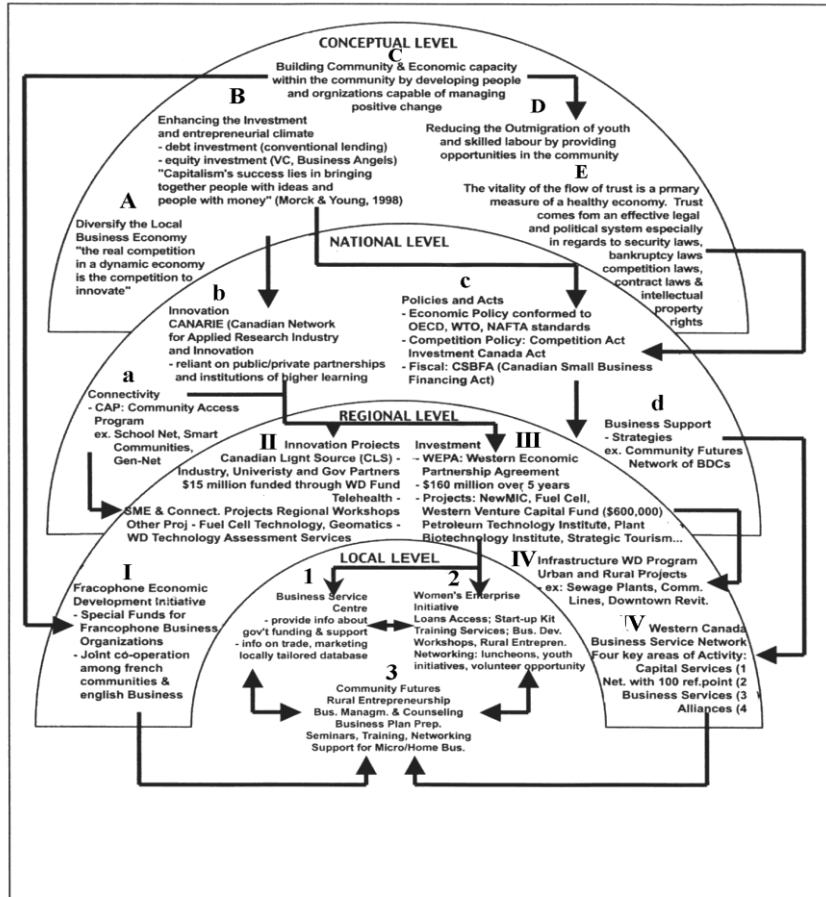
Annex 2. Four Models of Systemic Competitiveness

Fednor Wd Acoa Ctt (Urban)

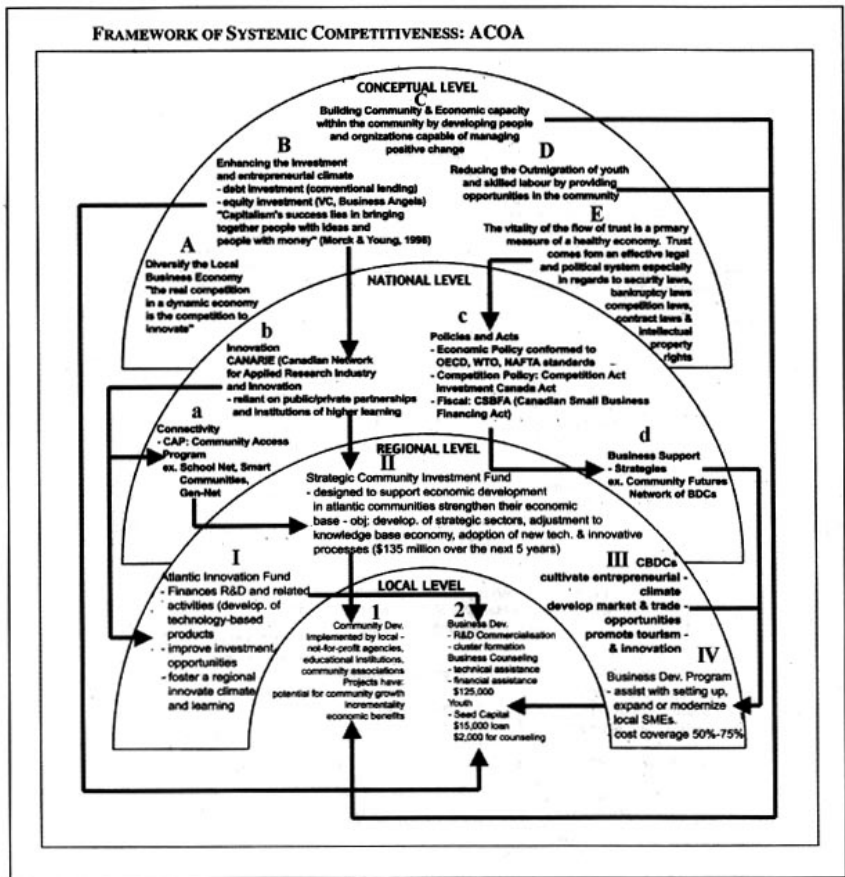
FRAMEWORK OF SYSTEMIC COMPETITIVENESS - FEDNOR



FRAMEWORK OF SYSTEMIC COMPETITIVENESS – WESTERN DIVERSIFICATION



FRAMEWORK OF SYSTEMIC COMPETITIVENESS: ACOA



Canada Technology Triangle (Waterloo, Cambridge, Guelph) - Model of Systemic Competitiveness

