

# **Regional Development and Regional Policy in Russia During Ten Years of Economic Growth**

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The paper shows spatial disparities in regional social and economic development under the influence of resource-related, geographic, scale and institutional factors. Leading and lagging regions are determined. Regional policy priorities are estimated in accordance with opportunities and barriers of spatial development of Russia.

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Despite of spatial persistence, ten years of steady growth had a great influence on territorial development of Russia. In regional economy and economic geography analytical equipment is accumulated that permits to understand better and forecast changes. In Russia there appeared opportunities and instruments for active regional policy implementation. Consulting market was formed with serious battles for orders for creation of regional development strategies and programs. But, according to the well-known economists' joke, growth is present while happiness is not. There are at least three reasons for that.

## **Regional development: strict opportunity limitations**

The strictness of these limitations is accounted for by many problems. It is conventional to point out strong regional disparity among the most severe problems and give striking quantitative examples of differences. But precisely calculated GRP per capita corrected according to the price level for Tyumen region with autonomous districts is 4 times greater than the All-Russian average, for Moscow – 2 times greater, and a dozen of other regions have GRP per capita higher than average. A quarter of all-country population lives in these regions. However, nearly 2/3 of regions do not differ greatly according to the level of development – the difference is in the range between the average and its half. 2/3 of Russians live in them. A dozen of regions with 6% of All-Russian population are obvious outsiders with GRP per capita less than 40% of the average. Spatial disparity in Russia is significant, but it is not greater than in other catch-up development countries with large territories. There is no sense in comparing Russia with European Union due to differences in territory assimilation and level of

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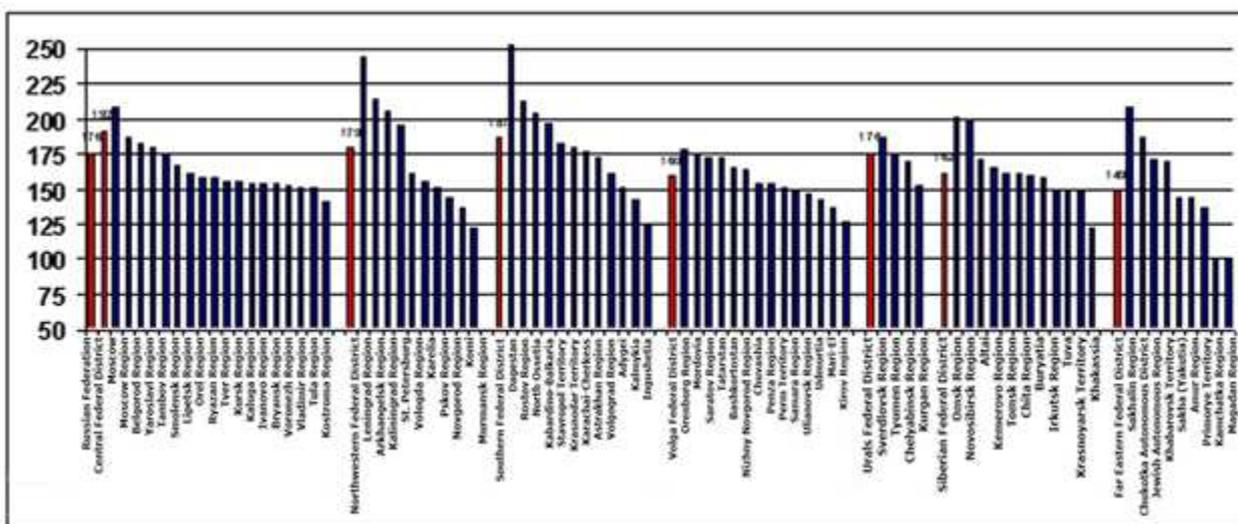
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development. The problem is not in disparity itself but in its negative influence on modernization of conditions and style of life. Large gap between several leaders and huge “median zone” slows down spatial spreading of innovations, since only one quarter of Russians live in places where resources for modernization are available. Social support to outsiders is provided at the federal level, and what about the majority living in the “median” regions? Their own economic opportunities are insufficient for development, and federal resources will never be enough for all. These are the regions which lack institutional enhancement, local community activation and competent regional policy most of all. To the author’s point of view, weakness of these important development factors significantly explains difficulties of modernization in the country.

Russia is distinguished by high territorial concentration of the economy: due to metropolitan deployment of large Russian companies’ headquarters, Moscow’s GRP is 23% of aggregate GRP of regions and the share is constantly growing. Incomes of Muscovites and metropolitan budget constitute 20% of all population income and budgets of all Russian regions, while the metropolitan share in population is only 7%. Moscow together with Tyumenn region provide 35% of total GRP of the country, ten largest regions form 57% of GRP, and the rest regions do not influence economic “weather”. But this situation is unique. For comparison, in Kazakhstan 22% of gross added value is provided by Almaty with 10% of population, that is, degree of concentration of economic activity in the largest cities of Russia and Kazakhstan are quite comparable. Agglomeration of production accelerates development if this process is natural but not administrative. In Moscow the role of administrative factor is too large and this distorts regional competition conditions.

Another problem is low quantity of growth factors and too strong barriers. This is particularly seen by GRP dynamics. Eastern regions with poor infrastructure which are under negative influence of rise-in-price factors - low population density, remoteness, unfavorable development conditions, significant population decrease due to migration outflow (fig. 1) – were the most slowly growing. GRP growth rates of the Far Eastern Federal District during 1998-2006 were the lowest, excluding oil producing Sakhalin and Chukotsky Autonomous District. Maximal growth rates were in the Central, Western and Southern regions of Russia, but in whole changes for federal districts hide significant differences: in the Center as well as in the North-West agglomerations of two federal cities were the “motors” of growth, which once more indicates the role of the scale factor in the country development. Only half of other regions with multi-million cities were quickly growing - Sverdlovsk Region (scale factor and export-oriented metallurgy), Rostov, Novosibirsk and Omsk regions, but after crisis recession their 1998-year rates were lower, that is why low base effect worked additionally. In Russia mineral resource (oil

and gas) supply factor works along with the scale one. Ultrahigh growth rates of Arkhangelsk region are ensured by its member, the Nenets Autonomous Area, in which oil extraction increased 13 times during the first decade of the XXI century. Sakhalin is one more example.



**Fig. 1. GRP index for years 1998-2006 for federal districts and federal subjects of Russia (year of 1998 =100)**

But not only regions with competitive advantages turned out to be the leaders. The highest growth rates were in underdeveloped republic of Dagestan – increase 2.6 times during 1998-2006, though relative reliability of statistical data and influence of low base effect should be considered. Russia differs from catch-up development countries in more strong equalizing policy of the government. Due to federal support, growth rates of many of less developed republics are closer to that of dynamically developing strong regions. However, non-market governmental services provided at the expense of financial aid of the federal budget dominate in GRP structure of less-developed regions, thus steady basis for development is absent.

Most of Volga and Ural regions with large agglomerations and high-tech machine building are out of the group of growth leaders. And as a whole, the influence of advantages such as human capital concentration and especially institutional quality on development of Russian regions is still weak. “First nature” factors [17] - resource endowment and geographical position - are dominant. Among “second nature” factors only agglomerative (scale) effect plays significant role, which is typical for the largest cities. Spreading of the accelerated growth zone over a broad spectrum of regions remains the most significant task in perspective, but that is impossible without increasing quality of institutions and human capital.

Strong lag effect of existing development trends is preserved until now since disparity is reproduced by the geography of investments which concentrate in oil-and-gas extraction regions

and in metropolitan agglomerations<sup>2</sup>. Ten leading regions in 2006-2007 attracted one half of all capital investments. Only in recent years per capita investment in maritime seaport regions of the country's West and South grew up to the Russia's average level. Industrial growth tendencies are also similar. Industrial production level of the Soviet period end is restored or exceeded only in half a dozen of regions. These are regions of export resource extraction and primary processing, areas around federal cities growing due to the scale effect, and some regions with favorable geographical position. Less developed republics were actually de-industrialized and retained only 13-40% of the 1990-year production level.

In whole, the level and dynamics of regional development reflect the dominant role of competitive advantages which are not connected to the modernizing activities of the government and society. The leading regions are divided into three groups which are typical of the catch-up development countries:

- the largest agglomerations of the country and some regions with multi-million cities;
- resource-extraction regions, especially new regions of oil extraction;
- separate maritime regions on the basic trade routes (the Leningrad and Kaliningrad regions, the Krasnodar territory).

Stability and even increasing of territorial differences according to the majority of socio-economic indicators is confirmed by dynamics of Gini coefficients calculated for the estimation of regional disparity<sup>3</sup>. Economic disparity of regions grew quickly<sup>4</sup> as well as differences in the unemployment level since labor market conditions are tightly bound with the economy as a whole (fig. 2). Neither does social governmental policy provide steady equalizing effect which is confirmed by Gini coefficients measuring regional disparity by per head income and subsistence minimum. Until recently, disparity in the life expectancy also grew as a consequence of geographical polarization of life style. For the population of the largest cities and the most wealthy regions the value of healthy life style gradually grows, while at the depression territories of the Non-Black Soil Zone and Eastern Siberia, especially at the rural districts, the process of social marginalization of population proceeds. The break of the negative trend in 2006 is provided by the increased public health investments which raised accessibility of primary health

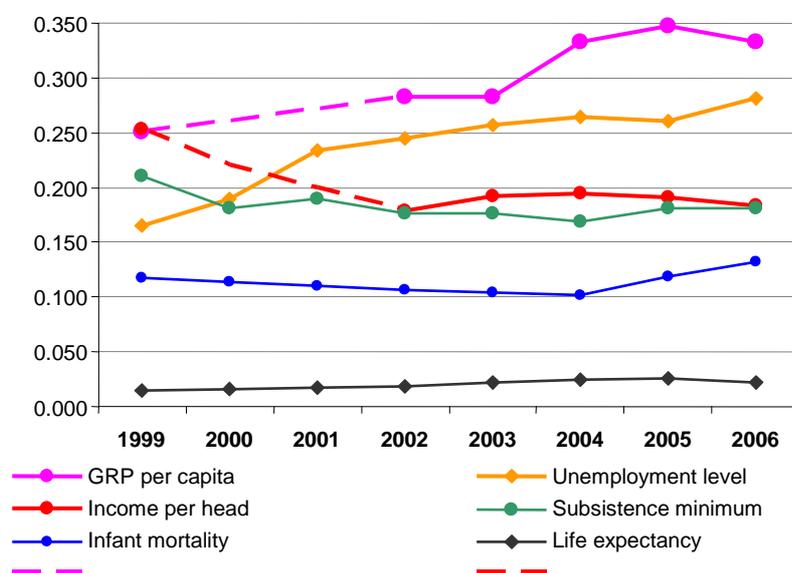
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<sup>2</sup> More comprehensive analysis is provided at the Independent Institute for Social Policy website in the "Social Atlas of Russian Regions": [http://atlas.socpol.ru/overviews/econ\\_condition/index.shtml](http://atlas.socpol.ru/overviews/econ_condition/index.shtml)

<sup>3</sup> The technique is similar to traditional calculation of disparity by income of population groups, but instead of decile groups regional indicators weighted by their population sizes are used.

<sup>4</sup> Decrease in GRP per capita in 2006 was caused by statistical factor only – data for six autonomous districts that were in the group of underdeveloped regions and were united with "mother" regions are no more published, thus, comparability was broken.

care and slightly decreased too high male mortality primarily in the most problem regions. However, these measures are unable to change marginal life style of considerable part of population. The dynamics of Gini coefficients for regional disparity in infant mortality is also ambiguous. At the years of economic growth the indicators themselves as well as regional differences decreased due to popularization of family planning and increase in governmental investment to medical and diagnostic equipment. But since 2005 the trend changed as a result of usage of “maternal capital” for birth rate stimulation. In turn, this lead to rise in births in high-risk groups. These groups are irregularly allocated among the regions, that is why regional differences in infant mortality increased.



**Fig. 2. Gini coefficients for regional disparity in Russia according to the basic socio-economic indicators<sup>5</sup>**

Lag effect and contrasts of development are strengthened by the depopulation problem. Demographical resources of the country reduce the worst in the most elderly regions of the European Centre and North-West, excluding two metropolitan agglomerations. Only in 6-7% of Russian regions natural population growth will be retained in the midterm. Birth rate stimulation measures are not able to solve the depopulation problem. The scope is too large: more than 70% of the country population live in regions with significant natural loss (0,5-1,5% a year), including 16% of population living in areas with extremely high natural loss of 1-1,5%. Demographical

<sup>5</sup> GRP per capita and money income of population are corrected with regard to price differences in the regions which are measured as the ratio of regional subsistence minimum to the Russia’s average subsistence minimum. Due to absence of subsistence minimum data for many regions for 2000-2001, calculation of Gini coefficient for GRP and per head income of population was not carried out for these years.

processes are inertial, thus, natural loss will further “squeeze” habitable area, especially quickly – in elderly regions of European part of Russia. Demographical resources of southern republics with growing population are the country’s last reserve which will disappear during the lifetime of one or two generations.

Possibilities of using migration resources are limited, net migratory inflow to Russia was 4-5 times reduced in comparison with 1990-ies. The migration directions have also changed due to replacement of stress factors by economic ones. In 1990-ies, the main migration flow was directed to the southern and western regions of Russia, but after 2000 only small inflow zones remained in these regions. Centro-peripheral migration vector typical for the previous decades was restored in the country: the population leaves remote and less developed regions and concentrates in the largest agglomerations. Return to the long-term trend of the XX century means that modern migration directions are stable and will be maintained in the future. According to estimations, migrations will compensate natural loss only in Moscow agglomeration, migration resources will not suffice even for St. Petersburg [3].

Summarizing, let us formulate the main conclusion: without increasing the role of "second nature" factors - scale (agglomerative) effect, human capital and modernized institutions - regional development will continue going along a smooth track, preserving existing disproportions and not changing economic and social landscape of the country. The country of perpetually catch-up development.

### **Regional science: weak analytical support of decision-making**

Spatial development research comes across a whole group of problems. The first and the most important one is peripheral position of Russian scientific schools in international regionalistics and slow flow of new ideas. In 1990-ies school of “new economic geography” appeared [16]; the school developed the theory of spatial concentration and its indicators with implementation of mathematical tools technique. The attention to research on institutional factors of regional development grows, though the developed approaches and methods are not universal [10]. The research on cluster-based policy and competitive abilities of regions widely spread in Russia too, though at times with misinterpretation of clusters as Soviet territorial production complexes. There appeared fashion for all kinds of regional indices, although they are methodologically vulnerable and are not always science-based.

The second problem is non-integrativity of research organizations and poor information interchange. Weak cooperation of regional economy and economic geography was preserved since Soviet times. Atomism and autarchy are typical for research organizations or groups

adhering to different ideologies (dirigistic or liberal) which use different analysis techniques – economico-mathematical, frequently without knowledge of regionalistics, descriptive-statistical in the style of Soviet planning analysis, qualitative methods with far-reaching conclusions by a small sample. The diversity of approaches and methods is an advantage if exchange of scientific results is established and informative discussions are possible, but in regionalistics there are none (!) wide grounds for such exchange, and this can tell much.

The third problem is barriers between research and consulting. In research still there are few explicit and clear to authorities recommendations, and in consulting which has spread following market demand, analytical component often remains superficial due to conveyor system and poor quality of studies. As a result, there appear virtual strategies and region and city images with the only aim – satisfy the customer, and if it comes into conflict with real life (tendencies, resources and regional development barriers), so much the worse for the life. However, it is consulting organizations who are often involved in regional policy development by governmental authorities.

In spite of these problems, much is made for understanding regional development tendencies. One can mention relatively recent research on regional disparity processes [12], disparity indicators and dynamics [15], urban and rural transformations in the long-term retrospective and in the transition period [1], [14], adaptation of rural areas of different types [7], [8], social development of regions [9], priorities and instruments of regional policy [5], [4], [2], leading regions development [13], [11]. The research scope is not limited to the mentioned studies.

However, in professional society there is no common opinion on basic problems most important for regional policy development. The first problem – whether regional disparity increases during economic growth, and are these tendencies abnormal. As mentioned above, according to calculations by Independent Institute for Social Policy, economic and social disparity measured by Gini index continues growing. The results of research made by the Institute of Transition Period Economy (data for 1999-2004) and used in the World Bank Report on Russia which is being prepared for publication it is stated that increase in economic differences of regions is not observed. One can dispute about the methods, but more important is to understand actual situation. The tendency of growth of spatial economic disparity within countries is theoretically explained by the concentration of economic activities at the territories with competitive advantages. This tendency is statistically demonstrated for different countries in the recent “World Report on Development” by the World Bank [18] devoted to spatial development. Hence, growth of economic disparity of regions is not abnormal but a result of

objective factor influence. At the same time, social disparity of regions can decrease but only in some of the developed countries. Certain social equalizing is achieved by large-scale and effective social policy which re-allocates resources to the benefit of low-income population groups [6]. That is why social policy enhancement is required first of all for smoothing social differences, along with increase of investments in human capital. Such policy is oriented to people but not regions.

The second problem is the way of typologization of Russia's territory in view of conditions, level and dynamics of spatial development. This is very important for development of adequate regional policy which employs different instruments for different types of regions. Typologies acknowledged by professional society do not exist, and there is no serious discussion of approaches for solving this complicated problem. Numerous exercises of economists in clusterization and other methods of mathematically strict division (geographers have had this disease as far back as in 1970-80-ies) cannot be admitted successful. Space "resists". The reason hides in the increased mosaicity, blurring and transformation of customary region types, asynchronous change of separate components of development. Nevertheless, the clue to the given problem should be searched for, and this is a problem of economic geography which is traditionally stronger in regionalization problem solution.

Imperfection of methodology, weak cooperation of research organizations and unsolved basic problems have not only scientific consequences. In Russia methodological an analytical base for governmental decisions in regional policy is weak. As a result, the authorities make decisions to the extent of their comprehension of situation.

### **Regional policy: indistinct priorities**

Regional policy of any country comprises two vectors – equalizing and stimulating development. During almost all transition period the first vector dominated in Russia so far as there were no funds for stimulating policy. Since the middle of the first decade of the XXI century, spatial development stimulation comes to the fore. Is the country ready for a new balance of the two vectors and implementation of effective stimulating policy?

It would seem that it is easier to stimulate growth under centralization of control ("vertical power structure") and overconcentration of tax resources at federal level. However, ineffectiveness of overcentralization which transforms regions to passive executors and increases dependency became clear even to federal authorities, and judging by D. Kosack's declarations, its peak has passed. Overconcentration of administrative and financial resources is dangerous to

stimulating policy too – when the Centre possesses much resources and power and the feedback with regions and other interest groups is weak, the risk of overestimation of own capabilities and making false decisions under pressure of powerful lobbyists increases.

Both regional policy vectors are formally established, development institutions are created, the spectrum of utilized stimulating instruments is expanded. Equalizing vector still dominates in interbudgetary relations, this function is executed by the Fund of Financial Support of the Regions (FFSR) which share in all federal budget transfers at present is one third. Other big Funds (compensation funds, social expenditure co-financing funds) formally are not aimed at regional equalizing but actually perform this function since in less developed regions the share of social transfer recipients is higher. Federal targeted investment program (5-6% of transfers) and federal purpose-oriented programs carry out stimulating functions, financial resources of Funds mentioned above are partly spent on investment, thus it is difficult to determine precisely the share of expenditures on stimulating policy (20-30% according to estimates). The problem is intense political nature and lobbism during making decisions on region financing and, as a consequence, insufficient transparency, excluding FFSR funds allocation according to the approved formula. As a result, the competition of regions for investments often acquires hidden forms.

The main difficulties of development and implementation of effective stimulating policy hold not in instrumental but in conceptual plane. Firstly, it is an intention of the Regional Development Ministry to ensure quick growth of less-developed regions by attracting investments. The experience of European Community countries shows that stimulation of economic growth of lagging regions doesn't give the expected effect, business prefers investment to territories with competitive advantages - scale (agglomerative) effect, lower economic distance (favorable geographical position), better institutions reducing development barriers, higher level human capital. Investments to less-developed regions have low return (excluding infrastructure investments by the government) if some competitive advantages are missing. For example, cheap and relatively qualified labor force in combination with low shipping costs and low institutional barriers, as in maritime special zones of China and in some other Asian countries. Or competitive advantage of marketable mineral resources if business is ready to invest in their extraction by itself and right now but not in remote strategic plans and with essential governmental support. In the rest cases more evident equalizing effect can be achieved by effective social policy and investments in human capital.

Secondly, spatial priorities for development are not determined. At first economically strong regions played the role of spatial priorities, these regions were designated to be “growth

engines” at federal authorities’ option and pull weak neighbours adjoint to them (the first edition of Regional policy concept developed by the Regional Development Ministry in 2005). After agglomeration of underdeveloped autonomous districts accompanied by considerable financial and political expenditures the questionable idea was rejected. Simultaneously, the priority of the Soviet past was resuscitated – exploration of eastern regions with extensive industrial and infrastructural projects but disregarding financial and human resource limitations (first editions of the Long-term development concept). For example, for Yakutia extensive industrialization program was developed – from metallurgical plants to coordinated hydroelectric systems – with required investment of \$20 billion which 1.5 times exceeds all direct foreign investment to Russia in 2006. Northern and eastern projects became prioritized, again was the Northern Sea Route announced strategic, though population and economy of the Far North contracted many times in comparison to the Soviet period. Under transport infrastructure recession in the main settlement zone populated by more than 90% of the Russian Federation citizens, swift shift of governmental investment priorities towards east is questionable. Natural resources as competitive advantage should be used for the country development, but relying on them is dangerous due to market variation of prices and is fraught with stagnation – mind the “resource curse”. Effective utilization of resource advantages is possible only under selective governmental support to the projects most significant for the country development and financed by business, with respect to strict human and material resource limitations in the regions of their implementation.

We’d really appreciate if a smooth track of resource development will be abandoned. In the last edition of the Long-term development concept, the notion of innovation-based development is supported by appointment of agglomerative and infrastructural priorities. In Russia only large cities are potential centers of innovation-based growth due to human capital concentration. However, the mechanisms of their support are not described in detail. Instead of this, regional authorities compete in “outlining” future agglomerations, and most part of revenue from taxes in large cities are withdrawn as usual. Current priorities of regional policy are quite different – either geopolitical (not sufficiently financed programs of the Far East development and special zone in the Kaliningrad region) or aimed at “public relations” (the Olympic Games in Sochi, the APEC summit in Vladivostok).

Thirdly, the Regional Development Ministry is planning specialization of regions for decades in advance. Gosplan doesn’t exist any more but its spirit is alive. This is one more demonstration of path dependence in mentality and politics, but the former territorial production complexes are now called clusters. In fact, regions are prescribed specialization in the Soviet

manner, regardless of how do these specialized industries survive in the market economy. Unreasonableness of such planning can be confirmed by one example – who could know a pair of years ago that Kaluga will become an automobile industry center? These efforts are relatively harmless so far as private investments can not be planned while their share is 80%.

The Ministry tries to overcome feedback weakness under “vertical power structure” by gathering opinions of the regions of prioritized industries and infrastructure objects. But it is impossible to determine priorities for the entire country on this basis. There exists an impartial conflict of interests of the whole (state) and a part (region): what is favorable for a region does not always accelerate development of the whole country. Trade-off decision of this perpetual conflict is possible, but at least the first step should be made – broad discussion and statement of spatial priorities for development of Russia taking into account purposes, opportunities and limitations.

Fourthly, regional policy obviously lacks sensible understanding of opportunity barriers. Depopulation, attraction of population to habitable regions of the country and to large agglomerations, lack of human and financial resources for extensive “assimilative” type of spatial development enforce rigid attachment of priorities. It is senseless to talk about extensive development of eastern regions and resettlement of migrants in them, it is impossible to put back the clocks as if there were no resource limitations. In the east and in the north of the country life forces to focus on target-directed development of large cities, ports and infrastructure corridors which allow to maintain weakly populated areas. Also target-directed should be infrastructural governmental support of effective resource-oriented projects financed by business.

With strict opportunity limitations it is desirable to stake on what grows by itself. In Russia growth areas determined by availability of competitive advantages are already formed. Nevertheless, there is no comprehension about the kind of supporting policy they need, though strong growth of such regions accelerates development of the whole country. Growing competition of regions for human and investment resources is obviously underestimated in spite of the fact that this particular competition but not plans of ministries and departments will determine spatial development. Those who are more attractive to people and business will win.

Summarizing, one has to admit that in regional policy reasonable balance between dirigistic and liberal institutional approaches is not yet found. Understanding that regional policy should be aimed at maximal utilization of region competitive advantages, coordination of territorial governmental strategies and business strategies, softening of market failures by effective re-allocation is just forming. But this is possible only after cardinal modernization of institutions and growth of human capital including in governmental authorities.

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