

**“THERE IS NO MIDDLE CLASS IN THIS OBLAST.
THERE ARE RICH AND POOR.”:**

**ECONOMIC AND SOCIAL POLICY TRADE-OFFS IN THE
RUSSIAN REGIONS**

An NCEEER Working Paper by

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Executive Summary

On the basis of in-depth case studies of four Russian regions, Kirov and Voronezh oblasts and Krasnoyarsk and Perm' krais, the trade-offs among social and economic policy at the regional level in Russia are examined. All four regional governments seek to develop entrepreneurship while preserving social welfare obligations and improving compensation in the public sector. Richer regions have a greater ability to reconcile social commitments with the promotion of business. Regions differ in their development strategies, some placing greater emphasis on indigenous business development and others seeking to attract federal or foreign investment. Governors have considerable discretion in choosing their strategy so long as they meet basic performance demands set by the federal government such as ensuring good results for the United Russia party. In all four regions, governments consult actively with local business associations whereas organized labor is weak. However, the absence of effective institutions to enforce commitments undertaken by government and its social partners undermines regional capacity to use social policy as a basis for long-term economic development.

Introduction

In his classic study, *The Great Transformation*, Karl Polanyi argued that as market relations upset traditional feudal ties between workers and owners, the harsh imperatives of capitalism threatened to deprive capitalists of a reliable supply of labor. In response, owners were forced to devise means to guarantee workers a certain minimum standard of living. Polanyi famously called the simultaneous advance of the labor market and social welfare institutions "the double movement."¹

Polanyi's double movement eventually took a range of forms, as the literature on the varieties of capitalism has demonstrated. In "liberal market economies," competition in the markets for labor and capital complements a competitive, majoritarian electoral system, yielding clear distinctions between winners and losers in the economy as in the polity. In "coordinated market economies (CME)," complementary institutions in the political sphere, economy and society regulating a society's labor market, social welfare and human capital development can mitigate redistributive tensions over taxing and spending policy, erasing the bright line between market winners and losers. In these CME's, spending on education and training, income security, and regulation of the labor market can yield positive returns to economic growth. Overall, LMEs may be no less successful economically than CMEs, but the gains and costs of economic competition are distributed far more unequally.²

As in Polanyi's early 19th century England, the regime change in Russia and other post-communist countries also challenges policy makers to devise new structures for social provision

¹ Karl Polanyi, *The Great Transformation: The Political and Economic Origins of our Time*. (Boston: Beacon Press, 1957 [1944]).

² Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism*. (Princeton: Princeton University Press, 1990); Hall, Peter A., and David Soskice, *Varieties of Capitalism* (Oxford, Oxford University Press, 2001), "Introduction"; Torben Iversen, *Capitalism, Democracy, and Welfare*. (Cambridge: Cambridge University Press, 2005).

and economic management consistent with the transition to a market economy. The conflict between those who seek to maintain some or all of the comprehensive guarantees of employment, housing, education, health care, pension security and poverty relief, and those who aim to reduce the socialist welfare state to a minimum set of fiscal commitments has shaped politics both at the central level in Russia and at the regional level. Regional governors face the challenge of stimulating growth by providing an attractive environment for capital investment while at the same time ensuring social stability. Accordingly, they must resolve the trade-off between reducing taxes and other burdens on the productive sector and continuing or even improving the level and quality of social benefits demanded by the population and regarded by the authorities as essential to preserving political support.

In this paper, we examine the strategies adopted by regional governments in Russia in the face of this redistributive dilemma. Specifically, do governors have a long-term strategy for regional development that would use measures of social policy to contribute to long-term growth? What are their social and economic policies? For example, how do they balance their obligations in the spheres of education, health care, unemployment benefits, housing and utilities rates, poverty relief, and support for vulnerable and dependent strata, against their desire to stimulate economic development? Finally, what leads governors to choose one set of social and economic policies over another?

Our initial question was whether governors see it as their goal to build up a middle class, understood as a body of property owners, taxpayers, investors, and citizens sharing values favorable to social stability and economic growth.³ Our premise was that doing so could help resolve the dilemma of redistribution versus growth as well as to provide a base of support for

³ For a review of the Russian social science literature on the middle class, see Thomas F. Remington, "The Russian Middle Class as Policy Objective," *Post-Soviet Affairs* 27(2) (2011): 1-37.

the regime and, possibly, to favor democratic principles.⁴ At the same time, a goal as abstract as developing a middle class could only be part of a long-term development strategy. We saw the challenges facing governors as analogous to those dealt with by the central government. Like the central government, so also must governors in Russia solve serious problems of social policy. While reducing the share of state expenditures in the economy by lowering the tax burden for capital might induce greater investment and long-term growth, short-term pressures for maintaining and expanding the social safety net, propping up failing industries, and replacing worn-out infra-structure impose heavy demands on the budget. As a result of the deep decentralization of social policy in the 1990s, which has been only partially reversed in the 2000s, regional governments must cope with the responsibility for maintaining much of the social welfare system inherited from the Soviet state, maintain public services such as education and healthcare, and promote the interests of regional firms. They face a series of trade-offs as they attempt to meet these goals. They are expected to maintain social stability in their regions (failing to prevent public manifestations of social discontent resulted in the recent dismissals of the governors in Kaliningrad and Sverdlovsk oblasts) while at the same time ensuring a steady flow of budget revenue to the center. Thus governors face a number of pressing short-run imperatives that can preempt a long-term development strategy.

The Four Regions

In this paper, we seek to understand the determinants of the strategies ruling elites at the regional level pursue as they attempt to resolve these trade-offs. We focus on four regions, which vary in their level of economic development and the degree to which they can be

⁴ This idea has been repeatedly articulated by Vladimir Putin, Dmitrii Medvedev, and other senior policymakers and advisers. See Remington, "The Russian Middle Class."

characterized as open and pluralistic or closed and authoritarian: Perm' and Krasnoyarsk, which are relatively industrialized and prosperous, and have higher than average ratings for level of democracy; Voronezh, a moderately industrialized region with a large and relatively successful agricultural economy and with a democracy score slightly above average; and Kirov, a less industrialized region with a democracy score nearly equal to the Russia-wide median.⁵ As Table 1 indicates, the regions do vary substantially. The gross regional product per capita in Perm' and Krasnoyarsk krajs is substantially greater than that of the median region, and twice that of Kirov and Voronezh oblasts.

The structure of employment of the four regions is similar to that of the Russian economy as a whole, by sector, by distribution of enterprises by size, and by educational level. There are, however, significant differences across the regions in the composition of budget expenditures and economic dynamism. They differ in the share of the budget devoted to economic and social policies, level of capital investment, expenditures for technological upgrading. In these areas, Perm' and Krasnoyarsk equal or exceed the all-Russian average, and exceed Kirov and Voronezh oblasts.

Table 1: Social and Economic Characteristics of the Case Regions

	Russia-wide median⁶	Perm' krai	Krasnoyarsk krai	Voronezh oblast'	Kirov oblast'
Selected economic characteristics					
Gross regional product per capita, 2008 (rubles)	150748	223845	255340	126173	107386
Real income, 2009 (nominal income as multiple of regional subsistence)	2.62	3.2	2.77	2.36	2.26

⁵ Under the synthetic classification scheme proposed by L. M. Grigor'ev, Iu. V. Urozhaeva and D. S. Ivanov, Perm' and Krasnoyarsk krajs are industrial regions with large extractive industry sectors. Voronezh and Kirov are moderately developed with large agro-industrial sectors. See Григорьев Л.М., Зубаревич Н.В., Хасаева Г.Р. (Ред) Российские регионы: экономический кризис и проблемы модернизации. – М.: ТЕИС, 2011. с. 337.

⁶ Median regional value for Russia as a whole.

minimum)					
Number of small enterprises per 10,000 population	90	67	107	83	75
Distribution of labor force by size of enterprise (as % of column),⁷ 2008					
Large enterprises	80	83	83	81	81
Medium-sized enterprises	3	3	2	4	4
Small enterprises	10	11	11	12	11
Micro-enterprises	7	3	4	3	4
Distribution of labor force by sector (as % of column)⁸. 2009					
Primary	11	10	11	16	12
Secondary	26	32	25	23	26
Tertiary	62	58	64	61	61
<i>including education, healthcare, science</i>	17	17	17	14	19
Composition of employed population by level of education (as % of column). 2009					
Higher vocational	28	21	25	22	19
Secondary vocational	27	31	28	28	28
Elementary vocational, general 2ndary, and lower	45	49	47	50	52
Selected categories of total regional budget spending, 2009					
Economic (as % of total expenditures)	18	15	20	15	15
Social policy (as % of total expenditures)	15	15	14	17	17
Potential for modernization. 2009					
Capital investment per capita (thousands of rubles)	55.9	49.7	85.2	37.8	21.1
Innovation activity (as %) ⁹	9	24	12	9	8

⁷ Under federal law, large enterprises are defined as those with 251 employees or more; medium-sized as those with 101 to 250 employees; small with up to 100 employees; and among small enterprises are micro-enterprises with up to 15 employees.

⁸ The classification of sectors of public production is based on that of Daniel Bell. Primary sector (consists of branches based on natural resources): agriculture, mineral extraction, fishing, forestry
Secondary sector comprises branches processing extracted resources, including metallurgy, machine-building, chemicals and petro-chemical, light and food industry, energy, construction, and other branches.
Tertiary (services) sector: trade, medical care, education, management and administration defense, science, art, telecommunications, software development, and other services.

⁹ The share of organizations carrying out technological, organizational or marketing innovations among all organizations surveyed in the given year.

Spending on technological innovation (mln. rubles per 1000 employed)	5.8	7.3	5.6	4.4	1.6
Number of personal computers with internet access per 100 employed	15	14	15	11	10
Productivity of labor: GRP (mln. rubles per thousand employed), 2008					
Economy as a whole	501	455	515	272	217
Social characteristics of the regions					
Gini index, 2009	42.2	43.1	42.7	40.3	36.6
Rural population, 2009	30.85	21.7	21.9	36.5	33.9
Human Development Index, 2008	0.825	0.802	0.816	0.796	0.774
Number of employed persons per pensioner, 2009	1.73	1.77	1.87	1.45	1.61
Share of social payments in total cash income of population (as %), 2009	15	13	16	22	21
Share of social payments in total cash income of population (as %), 2009	15	13	16	22	21
Share of population older than working age	341.5	331	295	427	373
Political regime					
Democracy score (2001-2006 summary average) ¹⁰	26	38	38	29	26

Sources:

Regiony Rossii. Sotsial'no-ekonomicheskie pokazateli. 2010 (Moscow: Rosstat, 2010);

Maloe i srednee predprinimatel'stvo v Rossii, 2010 (Moscow: Rosstat, 2010);

¹⁰ The ratings were compiled by a team of experts under the direction of Nikolai Petrov at the Moscow Carnegie Center. They are available at:

http://atlas.socpol.ru/indexes/index_democr.shtml.

Each region was rated from 1 to 5 on each of the following items for various time periods:

1. regional political structure (balance of power, electoral versus appointment methods for filling offices, the independence of the judiciary and law enforcement, limits or violations of civil rights);
2. openness or closedness of political life (transparency, inclusion in national processes);
3. degree to which elections are free and fair; how competitive and honest they are; how much the authorities resort to administrative pressures and political interference; limits on rights of participation in elections;
4. political pluralism – the presence of stable parties, factions, and legislative assemblies, coalitions in elections;
5. the independence of the media;
6. civil society (nongovernmental organizations, referenda, forms of unsanctioned public activity, eg rallies, demonstrations, strikes);
7. elites: quality, reproduction, turnover (e.g., via elections); stability of procedures; diversity of elites, effectiveness of methods of coordinating their interests;
8. local self-government: presence of elected bodies of local self-government, their activeness and influence.
9. the degree to which the regime was free of corruption;
10. the degree to which the regime had pursued economic liberalization.

The differences in the regions' economic structure may account for the differences among the regions with respect to labor productivity. As the table indicates, labor productivity in Perm' and Krasnoyarsk kraia is 2 to 2.5 times higher than in Voronezh and Kirov. The social burden on the employed population in Perm' and Krasnoyarsk kraia is close to the Russian-wide average and is somewhat lower than in Voronezh and Kirov oblasts. On average, the ratio of working age population to pensioners is 20% higher in the first two than the second two regions. These differences may account for the inter-regional differences in real incomes and social inequality. The average income in Perm' and Krasnoyarsk is almost 30% higher (relative to the subsistence minimum) than in Kirov and Voronezh oblasts. Likewise the Gini index of income inequality is greater in the two wealthier regions than the two poorer regions, consistent with the general tendency for higher-income Russian regions to exhibit higher levels of income inequality.¹¹ Inequality would probably be greater and real incomes lower in Kirov and Voronezh except for the high share of social transfers in aggregate income in those two regions. As a percent of total income, social payments are almost 40% greater in Kirov and Voronezh than in Perm' and 25% greater than in Krasnoyarsk. These figures suggest how important social transfers are in the structure of income in the less prosperous regions.

Governors' Policy Goals

After 2004, governors were directly appointed by the president rather than being elected. Nonetheless, they still face pressures to produce good electoral results in federal and regional elections (State Duma and presidential elections, regional legislative elections). The center holds them responsible for their political and economic performance. A recurrent theme is that popular

¹¹ Thomas F. Remington, *The Politics of Inequality in Russia* (Cambridge University Press, 2011).

dissatisfaction with the governor and his performance is considered a sign of discontent with state authority ("*vlast*") more generally.

Respondents told us that the federal center sets two principal tasks for governors: to ensure social stability in the regions (meaning the avoidance of large-scale protest, serious violations of rights, or technological disasters), as well as ensuring good results for United Russia in federal and regional elections. Generally respondents said that a 60% level of support was expected. A governor's success in obtaining a good showing for United Russia in his region, on the other hand, improves his standing with the federal authorities and his ability to enact his legislative program in the regional assembly. Of course governors are also expected to follow the center's lead in social and economic policy. As one expert from Krasnoyarsk put it, "the krai works the way the government dictates from above."

However, notwithstanding the obligation to meet the central government's political and policy demands, governors do pursue their own personal goals. Some may see service in the region as a springboard to higher office. Some have private business interests in the region. In some cases, an outsider may bring business investment with him from another region, typically from Moscow. Some see office as a source of rents. Finally, some governors, installed with the help of a financial-industrial group, may seek federal subsidies that will benefit the interests of the commercial group that advanced him. Governors also differ in their ideological preferences. Some have a strongly liberal, ie pro-market, orientation (among our four regions, this characterizes Chirkunov of Perm' krai and Belykh of Kirov oblast') while others promote the interests of state enterprises. Governors have considerable discretion in choosing their strategies for regional development and balancing social protection against economic growth. They must choose between investing their energy and resources in infra-structure development--building

and overhauling roads, bridges, rail stations, industrial parks, sports facilities, schools, hospitals and the like--and changing the institutional environment in which decisions are made. From the governors' standpoint, however, the payoffs from reforming institutions are long-term in nature and are unlikely to benefit a governor before he leaves office.¹² Therefore governors often prefer to focus on projects with more immediate benefits.

We can get some purchase on the question of the governors' policy goals from comments by regional respondents contrasting the current governors with their predecessors. For example, in Kirov oblast, Nikita Belykh (who assumed office in January 2009) was said to differ significantly from his predecessor, Nikolai Shaklein. If Shaklein was focused on his private commercial interests and the extraction of rents, Belykh clearly seeks to make a political career.¹³ Shaklein was affiliated with big business, and specifically with two regional companies whose interests he was said to promote. Belykh, according to some respondents, sees Kirov as a platform for advancement, a way to show off his managerial abilities to the federal government and, prospectively, to position himself for higher office.

Even open critics of Belykh concede that he is not pursuing private commercial interests or using his office to extract rents. Some respondents would like to see him do more to promote the interests of regional companies at the federal level. A local business leader commented: "What should support for the region consist in? In intelligent lobbying for state orders. If the government lobbies to win state orders, then the effect will ripple outward to small and medium businesses. And the economy will start up. That's not happening."

Yet regardless of the governor's personal preferences, the situation in the region is such

¹² Nikita Belykh, "Chto mozhet sdelat' v Rossii odin gubernator?," Interview with Tat'iana Malkina, Polit.ru, May 31, 2011.

¹³ Belykh alluded to this in his interview with Polit.ru when he noted that he has no plans to run for president in 2012, but that an advantage to being young--he was born in 1975--is that he is able to look 20 or 30 years ahead. "Chto mozhet sdelat'."

that the regional government must expend substantial resources on social protection. A senior government official told us:

In this region, there is no middle class. There are rich and poor...The goal of our social-economic policy is to pull the majority of the population out of poverty. That is, to help the lower strata in particular. We don't have specifically economic programs of support [of the middle class], rather we stimulate civic activism. There are no direct measures directed at financial support of the middle class. There are indirect programs of support for those who could, after a certain time, become the 'lower middle class' [in English].

Another government official stated: "the policy in the oblast' is more social than directed toward developing business. That is, in the first instance that means pensioners."

Respondents in Voronezh also contrasted the current governor, Alexei Gordeev (in office since March 2009), with his predecessor, Vladimir Kulakov. The latter, we were told, was oriented to support for big businesses that were affiliated with his own interests, rather than developing entrepreneurship. The new governor (who previously was federal minister of agriculture and deputy prime minister) is thought to regard the governorship as a temporary appointment, after which he will return to federal politics. The goals his team articulates revolve around two tasks: attracting external investment into big business in the region, and supporting the underprivileged strata. ("We have as our top-priority task: attracting large-scale investment into the region, raising labor productivity, creating jobs, raising GDP, filling the budget, solving social problems," according to a regional government official). Both experts and government officials agree that developing entrepreneurship is not a major goal of policy. Nor is Gordeev

thought to be pursuing personal business interests.

The Strategy of Increasing Investment

There are two reasons for the strategy of increasing investment: the presence of large firms oriented to state orders, and the governor's contacts in Moscow. An expert told us: "Our governor now grasps, having looked around, that there are no resources: no natural resource base, no oil, nothing of that sort. As a result, I gather that Gordeev was seriously disappointed that he is in Voronezh rather than Stavropol'... And, quite appropriately, he took up projects that will yield a return, investments, state program funds... Basically, he is trying to bring in ministers, using his old ties, and investments." Experts say that to attract investment he is using a policy of tax exemptions. "As of now, of course, it's hard to say because nothing specific has happened, it's all on the level of informal understandings, but there is considerable potential," says an expert.

In contrast to Kirov and Voronezh, respondents in Krasnoyarsk thought that the goals of the new and old governors were largely the same. When he first took office, former governor Alexander Khloponin was regarded as someone who was mainly interested in his own firm's interests (he had been a senior manager in Noril'sk Nickel, which has a major presence in the region). Likewise the current governor, Lev Kuznetsov (appointed in February 2010), who made his career on Khloponin's staff, is not seen as interested in higher political office. As a result, respondents noted considerable continuity in regional social-economic policy.

The traditional means by which the region raised economic output was to work with big business and attract investment to the region. Now the authorities are talking more about the importance of building up small and medium business. A government official told us: "the

governor devoted his first conference to the problem of supporting small and medium business. He went out to a business-incubator in the city of Krasnoyarsk, gathered a group of business and expert figures, listened to what they had to say, set specific tasks that are more or less guiding how we are working now. He is appropriating huge sums of money from the budget."

Several representatives of the authorities explain this as follows. The region is trying to build up small business as a way of increasing employment, despite the objective necessity of working closely with large enterprises: as large firms are modernized, laid off workers need new jobs. A government official explained:

The lion's share of regional output, as well of course as budget revenues, comes from big firms...we need to create a comfortable environment for them, of course. At the same time we are trying to involve them into our large-scale social and infrastructural projects. Take for example Rosneft'. They built a new building for the Institute of Oil and Gas in the Siberian University, that is, they are engaged rather actively in our internal krai affairs....but at the same time, we must recognize that as these firms upgrade themselves technologically, personnel will be laid off, and therefore we have to build up small and medium business from the standpoint of employment.

The region pursues a "soft" tax regime, benefiting both small and big business, and reducing discontent with various informal corrupt practices. "Business is coping reasonably well--*normal*'*no*--with these taxes, and such taxes are acceptable to everyone. But there is also the concept of the 'administrative resource.' In several areas of business its share in the

distribution of revenues reaches 25-35%," according to an expert.¹⁴ But government insists that tax exemptions are still only at the stage of discussion. A government representative explained: "it will become clear [to business] when we propose our tax policy that will help it develop. The more you work, the more everyone receives. The same with the regions, with donor and recipient regions. We have six territories in Krasnoyarsk krai that are donors [to the regional budget]. Why can't our donor regions obtain a legal basis for ensuring that the better they work, the more they keep? But right now, it's the other way around: the better we work, the more is taken away."

Respondents in Perm' saw some change in policy goals when Oleg Chirkunov replaced Yuri Trutnev as governor in 2004. Unlike Trutnev, Chirkunov is thought to have no interest in making a political career at the federal level.¹⁵ But he has personal business interests in the region as owner of a chain of supermarkets. A governor whose business is not the dominant one in the region is fairly rare. In his case, having personal business interests appears to have some beneficial side-effects, in that his own commercial interests coincide with those of small and medium business more generally.

More than in any of the other three regions, the governor in Perm' clearly gives priority to economic growth over redistribution. This also distinguishes Chirkunov from his predecessor. A government representative noted that "When Chirkunov came...the model of social policy worked out under the previous governor was dismantled..The current minister of social policy is changing everything; his principle is basically to 'shake up' everything through officials as much as possible."

¹⁴ This presumably refers to expectations that businesses contribute to informal, unreported discretionary funds managed by the governor for electoral and other purposes.

¹⁵ Trutnev became federal minister for natural resources.

The chief goal, said respondents, is to build up small and medium business. According to a government official, "The governor is ready to support business and in fact is doing so. And we are receiving resources both from the krai and federal levels to do so. But money is far from all of it. There must also be an understanding by the boss...a definite position and greater desire and willingness to create a favorable atmosphere for small business."

Business Development and Social Protection

The region is also deliberately working to commercialize public services. "Our governor since 2007, at meetings with business, advances the idea that [President] Medvedev also recently put forward: that the state should get out of particular spheres, leaving niches for entrepreneurship. Including education. And private schools should be on an equal footing with public schools. Budget schools should cease being fully funded out of the state budget, but should work on the basis of a contract economic institution, getting a state order, fighting for it," declared a government official. The same policy affects both teachers and doctors: "We have a great many teachers and doctors, they are all public sector employees, but they are not entirely on the state payroll--we are trying to turn them over to the marketplace."

The government knows that there is resistance to this policy. An official in charge of human development policy commented: "Those who are inefficient are against our policy. It's hard for them in the market. I call that the zoo effect: it was warm, they fed you, not a lot, but every day. And now you release that little animal into the wild: he will die! People are leaving for Sverdlovsk oblast, because they are fleeing our policies that create incentives to work. As a result, Sverdlovsk oblast has a ridiculously high budget deficit." The government is also trying to improve the efficiency of its social policy. The same official said: "We want to determine

which social guarantees, which state support, the population needs most. Perhaps, between 30 and 35 years of age people need psychological support, or mortgage credit, or finding a job for a woman after the birth of a second child. We need people to have children, because we have a demographic crisis."

Thus governors adopt strategies tilting more towards business development or towards social protection depending on their own preferences and the resources and constraints that flow from the situation in their region. No governor in the regions we studied has adopted a radical strategy of shifting entirely back toward a comprehensive, Soviet-style statist economic and social policy, nor has any completely dismantled the legacy of state controls and supports. All have sought to work with local business interests, but some have put more effort into new institutional mechanisms for decision-making and placed greater emphasis on the development of entrepreneurship. In pursuing these strategies, governors tend to reinforce traditional patterns of personalistic leadership rather than to build up formal institutions of representation and participation through the electoral system or through tripartite bargaining with business and labor. In effect, governors face strategic choices similar to those of the national-level postcommunist states, where rulers can opt to ally with interests favoring market-oriented growth or with the sectors preferring to preserve traditional statist controls over the economy and a redistributive social policy.¹⁶ Policy change tends to be incremental, belieing the conventional view that Russia underwent a radical, "shock therapy," economic transformation (in contrast to China's "gradualism"). Seen from the standpoint

¹⁶ Timothy Frye, *Building States and Markets after Communism*. (Cambridge: Cambridge University Press, 2010).

of the regions, the record of the last twenty years suggests that actual economic and social change in Russia has been far more gradual than is usually recognized.

The Institutional Setting

Before examining these regional strategies in more detail, let us consider the institutional environment in which governors operate, focusing on three dimensions in particular. First is the political relationship between regional authorities and the federal center. Second are the fiscal constraints. Third is the set of channels of communication and decision-making connecting the regional government with organized interests, particularly business and labor.

Central-Regional Relations

Under the constitution, the federal government is responsible for ensuring implementation of a common policy throughout the country in the spheres of education, science, healthcare, culture and social welfare (Article 114). At the same time, administration of policy in education, science, culture, sports, social welfare, healthcare and family policy belongs to the joint competence of the federal and regional governments (Article 72, paragraphs f and g). Technically this means that regional governments must coordinate their actions with the federal government in these areas. In actuality, fiscal responsibility for many of the policies affecting social welfare was passed from the central government to the regions in the 1990s and only partially restored to the federal level in the 2000s. This meant that regional budgets have had to finance much of the comprehensive system of cash and non-monetary benefits inherited from the Soviet regime: education and healthcare, the highly subsidized housing and utilities sector, transportation, recreation, child care and other services, as well as the institutions for the needy

such as old age homes and orphanages.¹⁷ Because many of these services had been administered through state enterprises, the end of the planned economy meant that state enterprises could not afford to maintain them, but neither could regional and local governments afford to take them over. Yet at the same time, as noted above, preserving social stability remained a top priority. Both governors and local elites therefore regard a good relationship with Moscow as critical to maintaining the flow of regional subsidies and investments.¹⁸

John Reuter's recent analysis of the pattern of gubernatorial appointments under Putin and Medvedev indicates that the single strongest predictor of a governor's removal is his failure to produce a high vote for United Russia in regional and federal elections.¹⁹ Economic performance (output growth, controlling inflation, keeping down unemployment) is unrelated to governors' appointments, but effectiveness in keeping down utilities rate increases and other measures of economic management, as judged by the federal ministry for regional development, benefits governors' careers. A governor's popularity in the region also tends to protect him against removal. Thus a governor knows that the center is monitoring his ability to deliver political support for the national party political machine: signs of substantial social dissatisfaction that could erode popular support for the regime are damaging to a governor's career prospects.

Similarly, a study by Natalia Zubarevich of the social and investment priorities of the federal authorities in 2009-2010 found that the center responded more to political than to economic pressures: federal resources went primarily to regions that had suffered from forest fires in the summer of 2010, to the unstable regions of the North Caucasus, or to regions where

¹⁷ Remington, *Politics of Inequality*.

¹⁸ Alla Chirikova, *Regional'nye elity Rossii* (Moscow: Aspekt Press, 2010), p. 118.

¹⁹ Ora John Reuter, "Elite Appointments in Electoral Authoritarian Regimes: Evidence from Russian Gubernatorial Appointments," unpublished paper, Columbia University, May 2011.

there had been open manifestations of popular discontent (as in Vladivostok).²⁰ In the latter case, the governor seems to have kept his job only because of the importance to Moscow of the urgent preparations for the Asia-Pacific Economic Community meeting in 2012, which made continuity in leadership desirable.²¹

Still, while a governor must be attentive to Moscow's political and policy demands, his skill in forming alliances with local political and business leaders, especially by recruiting them to staff positions in his administration, is a critical condition of success. This is particularly so when a governor is appointed from outside the region rather than from among the regional elite, a trend which has become prevalent in recent years.²² Among our four regions, two illustrate the pattern of "outsider" governors, and two the pattern of insider appointments.

Nikita Belykh is an "outsider." Before his appointment as governor of Kirov oblast', Belykh had been a national leader of the liberal party Union of Right Forces, and before that had worked in the regional administration of Perm' krai (which neighbors Kirov). He brought with him to Kirov a team of like-minded colleagues. Still, many local officials remained in place from the former governor's team, limiting Belykh's room for manoeuvre. As a local businessman commented:

Belykh can't fire anyone. Whom can he fire? When he came here, he could not change the staff...the danger lies in the group that you could call the middle level of administration--deputy chiefs of departments and chief specialists in the departments;

²⁰ Н.В. Зубаревич. Социальные и инвестиционные приоритеты в межбюджетных отношениях центра и регионов на стадии выхода из кризиса. Доклад к XII Международной научной конференции по проблемам развития экономики и общества, Москва, ВШЭ, 06.04.2011, <http://regconf.hse.ru/uploads/5498b8d90e03f9a568de22ce3a02d96e20d9aae2.doc>

²¹ This was in fact the public justification given for reappointing Sergei Dar'kin governor. Полунин А., Латыпов Д. Путин не сдал Дарькина на откуп недовольному народу // <http://svpressa.ru/politic/article/19431/>

²² Nikolai Petrov and Aleksei Titkov, Eds. (2010). *Vlast', Biznes, Obshchestvo v Regionakh: Nepravil'nyi treugol'nik*. Moscow, Moskovskii Tsentri Karnegi.

those are the people Belykh can't remove...He could remove them, but only if he gradually put his own people in charge of the departments and gave them carte-blanche.

Belykh's difficulty is compounded by his strongly pro-market orientation. Some members of the local elite are skeptical of his independence of Moscow; given the depressed nature of the region, they would prefer to have a governor with strong ties to Moscow who could bring in resources.

The governor of Voronezh oblast, Alexei Gordeev, was also appointed from outside. Previously he had been federal minister of agriculture and vice-premier of the government. Consequently local respondents considered him someone with valuable contacts in Moscow. In contrast to Belykh, he has been successful in creating a team of like-minded associates from the region, partly by virtue of his success in attracting external investment. An expert commented: "A lot is connected to the figure of the new governor. ..In the first place, upon his arrival the volume of state investment rose sharply...We are seeing investment in the mono-cities [one-enterprise towns]. There aren't many of them, but we have some. And there are other social projects--a federal highway, bridges, moving of the railway station, and a number of other federal projects. They have begun to be appropriated actively under the new governor. Voronezh oblast has one of the highest levels of state investment."

In Perm', governor Oleg Chirkunov is an insider and inherited his predecessor's team. But he has established a different political profile from his predecessor. He has not attempted to assert control of large enterprises and has avoided conflicts with regional industrial elites. He has both assembled a substantial circle of associates and skillfully built up his own personal authority. Generally respondents from the business and expert communities admired his political and policy skills, commenting that he has pursued policies congruent with Moscow's priorities

while at the same time preserving the region's traditional distinctiveness and autonomy.

Lev Kuznetsov, the governor of Krasnoyarsk, is in a similar position. Much as Chirkunov had formerly been a member of his predecessor's team in Perm', so Kuznetsov comes out of Alexander Khloponin's entourage (he was first deputy governor before Khloponin was made presidential envoy to the new North Caucasus federal district, and a member of the board of directors of Noril'sk Nickel). Both Chirkunov and Kuznetsov inherited the staff of their predecessors, so did not need to expend time building up their own networks of associates and clients. Both had their own middle-sized businesses at the point they were appointed, which appears to have motivated them to work to improve the business climate in their regions. It is possible that, as Chirkunov has done in Perm', Kuznetsov will launch his own policy program to build up entrepreneurship in Krasnoyarsk.

Therefore, so long as a governor ensures that Moscow's political priorities are met, he has a considerable degree of autonomy in choosing his own priorities in the area of social and economic policy and forming his own governing coalition.²³

The Fiscal Environment

All regional governments face fiscal constraints, but poor regions have many fewer degrees of freedom. Although regions have their own revenue sources, among them most of the profits tax on businesses, two thirds of the individual income tax, and a direct tax on transportation, nearly all rely as well on fiscal transfers from the federal government. In poor

²³ On the other hand, governors have less and less influence over the regional branches of federal agencies, such as the procuracy, police, security services, tax authorities, and even fire fighters. As part of the centralization of federal power associated with Vladimir Putin, the regional heads of these bodies have been replaced with outsiders who are presumably loyal to Moscow rather than to the local political establishment. See Petrov and Titkov, *Vlast', biznes, obshchestvo v regionakh*. Also see Nikolai Petrov's comments at the Carnegie Center Moscow on October 13, 2010: <http://www.carnegie.ru/events/?fa=3080> accessed June 25, 2011.

regions, such as Kirov oblast', federal transfers comprise well over half of the regional budget.²⁴ Regions also rely on ad hoc off-budget contributions from enterprises for regional needs, for example to build infrastructure or sponsor sports teams. Governors have the discretion to lower or eliminate profits tax for enterprises in region in order to attract investment and in fact use this power extensively. Governments must choose therefore whether to lower the tax burden for business or to raise it in order to meet demands for social spending and to decide how to distribute regional budget and off-budget funds.

The extensive social benefits system inherited from the Soviet regime imposes a substantial fiscal burden on regional budgets, particularly in poor regions. Non-monetary obligations that were part of the command economy now must be financed with budget resources. These include both comprehensive benefits such as housing, health care and education as well as the hundreds of specific discounted and free goods and services to which particular categories of the population are entitled.²⁵ The fact that in Kirov oblast, over one third of the population receives one or another social benefit conveys some idea of how extensive these entitlements are.²⁶ A senior government official in Kirov said: "if you examine the budget of Kirov oblast, of course it has a social orientation. Some 60% is expenses in the social sphere."²⁷ But in the structure of these expenses the largest quantity goes to the system of social protection [*sotsobespechenie*]. That is, this is support for the elderly, invalids, pensioners, and so

²⁴ 60%, according to Governor Belykh, "Chto mozhet sdelat'."

²⁵ As of 2000, half or more of the population received one or another social benefit from the state. The Ministry of Labor estimated that the number was closer to 2/3 of the population--no one actually knew. A World Bank survey found that about a quarter of the households were receiving one or more benefits. The government estimated that their total implicit value equalled about 20% of GDP, equivalent to the size of the federal budget. This explains the urgency of placing the nonmonetary benefits system on a cash footing and providing income supplements to the population to purchase them. See Remington, *Politics of Inequality*, pp. 47-48, 64-65.

²⁶ Belykh, "Chto mozhet sdelat'."

²⁷ 58% of the consolidated budget goes to social welfare, education, health care and other social expenditures. This is the highest share of all four regions. The median Russian region figure is 55%.

on. The social payments that exist in this sphere is the biggest quantity of resources. Unfortunately, it does not include education, cultural employees, health care. But these are the social obligations of the state and it must fulfill them. You can't get away from them." Apart from the moral obligation, regional governments are also unwilling to countenance another wave of public protests by pensioners such as that which occurred over the attempt to monetize social benefits in January 2005. As a representative of the executive branch in Perm' noted: "We have restless pensioners. They will bang on saucepans, block the tram lines. Here they went on strike, dragged a bus, turned it over, and blocked the road to a gas station."

The Soviet social welfare system was regressive (ie higher-income strata benefited disproportionately), and, to some extent, the regressive nature of the tax and social benefits systems has continued into the post-Soviet period.²⁸ For example, while the income on which the social insurance payroll tax is levied is capped, pension benefits are not. Most people, poor and rich alike, still do not pay the full cost of utilities services such as heat, power, sanitation and water. But efforts to shift from a universal system of social benefits to one based on need meets with enormous political resistance, as the fiasco over the attempted monetization of benefits in 2005 demonstrated.

A number of respondents also pointed out that the regional governments must balance the interests of their capital cities and other large towns against those of the rural periphery. Another of the legacies of the Soviet planned economy is a severe maldistribution of population in Russia. That is, a substantial share of the population resides in territories that require large state subsidies to maintain.²⁹ Again Kirov oblast suggests the magnitude of the problem. According

²⁸ Remington, *Politics of Inequality*, pp. 51-2.

²⁹ Fiona Hill and Clifford G. Gaddy, *The Siberian Curse: How Communist Planners Left Russia Out in the Cold*. (Washington, DC: Brookings Institution, 2003); Allen C. Lynch, *How Russia Is Not Ruled: Reflections on Russian Political Development*. (Cambridge:

to Governor Belykh, the region has 2000 settlements with fewer than ten inhabitants and 8000 with fewer than 50. There are rural schools with fewer than four pupils.³⁰ Maintaining the infrastructure of social services over a large but sparsely settled rural territory imposes an enormous strain on regional budgets but attempts to close rural schools and hospitals face substantial political resistance from the rural population, as a number of our respondents pointed out.

Businesspeople are aware that they are financing the public sector's wages and the system of social benefits and government officials recognize the serious trade-offs imposed by the need to finance both the public sector and to stimulate business activity. A Voronezh entrepreneur told us: "The biggest misery for entrepreneurs is the enormous herd of municipal and state employees, who graze and trample all the grass...they live in order to live...and in order to sign some sort of paper on a land transaction, you have to go around the offices all over the country and gather about a hundred signatures." Respondents noted that regional civil servants--in contrast to rank and file doctors and teachers-- have seen substantial pay increases in recent years. According to Rosstat, the average compensation of regional state officials is almost two-thirds higher than the average earnings in the economy, and in some regions the difference is 2:1 or more.³¹ As a government official in Krasnoyarsk told us, "On the one hand, I am an employee of the ministry of economy, which is responsible for meeting budget revenue targets, including through tax revenues from entrepreneurial activity. On the other hand, I am head of the department for entrepreneurship and must facilitate in various ways the development of small

Cambridge University Press, 2005).

³⁰ Belykh, "Chto mozhet sdelat'."

³¹ For 2010, the average pay of a regional executive branch official was 37,400 rubles per month, or about \$15,000 per year. The average earnings in the economy as a whole was 22,700 rubles per month, or about \$9000 per year. And in addition to base salary, state officials are entitled to a wide array of cash bonuses and in-kind benefits, boosting actual income considerably higher. "Zarplaty regional'nykh chinovnikov v 1.5 i bolee raz prevyshaiut dokhody srednestatisticheskogo grazhdanina," *Vedomosti*, March 29, 2011.

and medium business. In that capacity I have to make decisions that will stimulate entrepreneurial activity, including by lowering the tax burden, simplifying the procedures associated with taxation, managing tax reporting, and so on. We make suggestions but our suggestions are not always accepted at higher levels." Moreover, the good pay and benefits and greater security of employment in the public sector are attractive to young people. The head of a business association in Kirov oblast commented that "there was a time when youth wanted to go into entrepreneurship, but today they all want to become officials. I have an acquaintance who has a daughter. She graduated from some municipal school, but he set her up in the city administration. What does that tell you about the state of society?" In view of the fact that the public sector ("budget sector" employees) comprises as much as a quarter of all employment in Russia,³² it is clear that much of the redistributive effect of regional taxation and spending is not from richer to poorer but from poorer to richer.

State-Society Linkage

The third set of institutions are those linking the authorities with organized sectors of society. We can divide these into two types, parliamentary and corporatist. The parliamentary institutions include regional legislative elections, parties, and legislative assemblies (note that in addition to enacting laws, regional legislatures also confirm presidential nominations for governors). The corporatist institutions include the settings for bargaining and consultation over economic and social policy among business, labor and government, known as the Tripartite Commissions and the Tripartite Agreements. Both sets of institutions work more in the breach than in fact. To be sure, neither is entirely irrelevant. As respondents reminded us, electoral

³²Budget employees' salaries were indexed each year since 2004 but not in 2010. As of December 2010, there were 17 million budget employees in Russia, out of a total of 68.45 million employed people. Polit.ru, August 20, 2009.

considerations often underlie governors' policies because they are held responsible for United Russia's success in federal and regional elections. Moreover, election to regional assemblies, and particularly membership in the United Russia party which dominates them, offers businesspeople valuable opportunities for lobbying, as does membership in the United Russia party. Therefore in all four regions, businesspeople are well represented among the deputies to the regional legislature. In Voronezh, deputies from business enterprises comprise 59% of the total; in Kirov, 70%, in Krasnoyarsk, 29% and in Perm', 64%. Nearly all of these are top-ranking managers, often the firm directors.

Electoral considerations are one reason governors pursue showcase projects. A political scientist in Perm' observed that: "Governors love high-visibility, high-impact things (*broskie, effektnye veshchi*)....If you look at any of our local newspapers, you can see that not a lot of attention is paid to small and medium business. That just doesn't have much resonance. Big-impact things occupy the governor more, everyone talks about them. In that sense a lot of money gets spent on all sorts of things to promote the Perm' brand." Electoral considerations may also help explain some redistribution of resources from the urban to rural sectors. As a government official in Voronezh told us, the rural population is larger and turns out to vote in larger numbers: "Turnout there is 70-80%, in the city at best it is 35-40%...Everything is being done to develop the [rural districts of the] region, specifically support for rural districts. For example, over the last 2 years we have built some 15 sports facilities, but in the city of Voronezh not one has appeared. If a sports complex is built in the city, it is private....In this year alone, two schools and polyclinics received money from the oblast' budget. Although that is crazy. We are building schools in villages with three thousand people, but not building anything here [in the main city]."

Similarly, governors use regional and federal budget funds to build new schools and hospitals. An example is a new medical facility in Perm' built with federal funds. A business person from Perm' told us: "I had friends who were invited to work in a new perinatal center, in a new location, there was a swamp, there officially you are not allowed to build, there is no permission. I asked my friend whether he would go to work there, and he replied: 'are you crazy? How can you set up a maternity hospital without a cardiac rehabilitation department, anaesthesia, or general surgery?' None of that is envisioned! If something is needed urgently, it needs to be in the next department. This is all close to being completed. Can you invite interns, young doctors to work in such a facility? They found a solution: they closed the regional maternity hospital, and everyone was forced to go to the new one. It will have a fine obstetrics department, but they will work with high risk. An uninformed person wouldn't see this, but would only see that there was a maternity hospital with 200 beds, but now there will be one with 1000."

With respect to the corporatist procedures for bargaining among business, government, and labor that occurs through the Tripartite Commissions, respondents uniformly treated them as purely pro forma. The tripartite commissions work out collective bargaining agreements over wage and other conditions to which business and labor are supposed to adhere. It is notable that in his 2011 message to parliament, prime minister Putin cited the federal-level Tripartite Commission as an effective, hard-working body facilitating dialogue and decision-making on economic and social policies. However, our respondents, like all experts who have studied the tripartite bargaining institution, concurred that it has no real impact on policy. This is for several reasons. Business, as our respondents indicated, faces difficulty in overcoming its own collective dilemmas: small, medium and large business differ in their needs, interests and level of

autonomy; firms compete for particularistic favors from government; and business associations themselves compete for members and government attention. Moreover, labor's organizational power is even weaker than business's, for many reasons (a respondent in Voronezh called the local unions "a soap bubble.") The close ties between workers and their place of work for social benefits has continued to inhibit collective action by labor long after the transition, and the clientelistic relations between trade union leaders and the state deter them from adopting an adversarial posture toward the state. All experts agree that in the tripartite setting, government and business dominate decision-making, with labor distinctively inferior in bargaining power.³³ Agreements generally reach the Tripartite Commission having been settled beforehand.

At the same time, in all four regions, albeit to varying degrees, government and business maintain active contacts. In some regions government even presses business to overcome its own collective dilemmas and to work through one or more regional business associations in formulating demands and bargaining with government.

In Voronezh oblast', for example, the regional Trade-Industrial Chamber takes part in regional government planning meetings and in drafting policy documents. In Krasnoyarsk, a vice-chair of the regional legislature told us about efforts to involve business associations into regional planning: "I would say that a significant share of the efforts of the regional authorities are directed at gathering them and organizing with them some sort of dialogue. But this is occurring with great difficulty. With great difficulty."

The Example of Kirov Oblast

Probably the region with the most active consultation between business and government

³³ Sarah Ashwin and Simon Clarke, *Russian Trade Unions and Industrial Relations in Transition*. (New York and Houndsmills, Basingstoke, Hampshire, UK: Palgrave Macmillan, 2003); Simon Clarke, *The Formation of a Labour Market in Russia*. (Cheltenham, UK: Edward Elgar, 1999); Simon Clarke, *The Development of Capitalism in Russia*. (London: Routledge, 2007); Walter D. Connor, *Tattered Banners: Labor, Conflict, and Corporatism in Postcommunist Russia*. (Boulder, CO: Westview, 1996); Remington, *The Politics of Inequality*.

is Kirov oblast, where Governor Belykh makes a point of discussing regional policy with business associations and where business associations are most fully developed; among them are the League of Entrepreneurs of Kirov oblast; the Council of Economic Directors of Kirov Oblast; the Viatsk Trade-Industrial Chamber; and Delovaia Rossiia. Both representatives of the business associations and of government agree that there is active consultation. Belykh told us: "Yes, we are in constant touch. One of my deputies is from that milieu. One of his responsibilities is to maintain constant contact with the associations. Plus they are constantly invited to various economic councils under the committees [presumably meaning standing committees of the regional legislative assembly] and so on. And of course we meet on an informal basis as well. Opora, the Viatsk Trade-Industrial Chamber, the League of Entrepreneurs. Delovaia Rossiia is pretty weak. But these are overlapping organizations. It's not even as much a matter of the representation of business-community. It's rather a matter of several tens of genuinely civilized businessmen, who are truly interested in realizing a high-quality social-economic policy."

This participation is institutionalized to some extent in that the heads of the Viatsk Trade-Industrial Chamber and Council of Economic Directors take part in meetings of the government with the right of an advisory vote. And in some cases, representatives of government take part in meetings of the associations.³⁴ A senior government official explained that business association representatives "are involved in the process of preparing policy decisions at all stages, at these preliminary stages they demonstrate their preliminary opinion, and we alter our drafts, and make some of our own proposals. Therefore, most often, there emerges onto the surface of the iceberg an opinion coordinated with our own."

³⁴ The same practice has been institutionalized at the federal level, where the RUIE and FNPR were given the right to attend meetings of the government. Polit.ru., January 11, 2011.

Frustration with the Business/Government Dynamic

From the standpoint of the government, including business associations in policy-making not only keeps business informed of government's intentions, but spurs businesses to meet their legal obligations to report actual wages paid to the tax authorities and to contribute to the region's social projects. At the same time, it gives businesses an opportunity to influence decisions before they reach the floor of the regional legislature. Business representatives cited several instances where business was able to influence policy (e.g. stopping government from raising electric power rates, changing the procedure for nominating judges to local commercial courts, and fighting successfully to maintain state loan guarantees to business during the recent economic crisis). Typically it is the governor who sets the agenda, often using such meetings to inform the business community of his plans and to seek their support. The head of a government-sponsored center for entrepreneurship in Perm¹ described the authorities' relations with business as mutually beneficial: "Of course we exploit them [i.e. the business associations], because they come to us to solve their own problems, and we pluck from them things like what they want, how they see things, what their attitude is, and so on. We exploit them for our purposes, but I think a mutual satisfaction is achieved."

Still, a number of respondents from both government and business expressed frustration at the nature of interaction between government and business, government at the lack of initiative coming from organized interests, business at the pro forma nature of the discussions. As a deputy of the Krasnoyarsk legislative assembly put it, "the political history of the last 20 years in the territory shows that our small and medium business is very diverse, it is not consolidated, so you can't say that anyone here is aggregating and articulating the interests of small and medium business." As a result, he added, even when the governor tries to conduct

¹"There is No Middle Class in this Oblast'. There Are Rich and Poor."

serious discussions with business, it is extremely difficult. "Even those opportunities that have been created for business by the regional authorities are far from always being used. And that is of course surprising."

A government official in Perm' stated: "You know, even our roundtables are not really discussions. I have never been at an ordinary roundtable, where there would be a normal dispute. Rather, each participant gives his own report. The banks, the organizers of the given round table, gave their report. But a roundtable where there was a real discussion, I have not had the pleasure of being at any such."

The dissatisfaction both sides express with the state of state-business relations appears to reflect the fact that neither side is able to commit itself credibly to agreements.³⁵ Governor Belykh himself regularly complains about the unpreparedness of organized social interests to assume responsibility and to honor agreements. At a roundtable discussion in September 2009 he vented his frustration:

We sit down at the table with [civil society] and discuss problems, reach an agreement, sign a protocol, and the next day they rally against everything outside my windows. This takes away any desire to conduct any sort of negotiations...The apotheosis of all this is the trade unions.³⁶

He echoed the same point in an interview in May 2011, when he observed how poorly

³⁵ William Tompson pointed out that one reason the understanding reached July 2000 between Putin and the oligarchs, whereby Putin pledged that the state would not attempt to interfere in the oligarchs' business dealing so long as they stayed out of high politics was that neither side had any means of ensuring its faithfulness to the agreement. He called this a "two-sided commitment problem." Cf. William Tompson, "Putin and the 'Oligarchs': A Two-sided Commitment Problem," in Alex Pravda, ed., *Leading Russia: Putin in Perspective* (New York: Oxford University Press, 2005): 179-202.

³⁶ Quoted in Polit.ru, September 11, 2009.

equipped both state and society are for dialogue with one another. The fault lay, he again asserted, not only with the authorities but with society as well. Therefore as governor he wants to change "the format for interaction between *vlast'* and society" but to do so is time- and energy-consuming, and the results will only be felt over the long term, not in a single governor's term of office.³⁷

A senior member of the regional administration in Kirov similarly found it hard for business to act collectively: "they [i.e. businesspeople] articulate their opinions, and intend to [take a broader view of policy problems], but it is a long way from voicing their own deeply parochial interests to more general interests. They all come here for something--to react to events, but they don't show initiative themselves. The way the agenda is set is that usually the government makes a particular decision, and business responds to it. But not the other way around."

For their part, business representatives commonly complained that their interests were not taken into account by government. A business person from Voronezh stated: "Therefore we say that there is a big difference between what is declared and what exists in fact. This difference occurs for this reason: up above [i.e. at the level of officialdom] there are only paper reports [*odni reliatsii*], but in actuality everything is otherwise. That is, there is no linkage from below to up above." Businesses are well aware that often the only reason government summons them to such a meeting is to request funding from them for a regional project. Businesses (and sometimes government officials) observe that the business associations themselves may be unrepresentative of the full spectrum of business interests, either being dominated by a few insider firms or serving purely as facades.

³⁷ Belykh, "Chto mozhet sdelat'."

Information Access

In almost all cases, business representatives complained about the lack of access to information about regulations and policies. Asked to characterize the business climate in his region, one respondent said "it's not a climate, it's a total fog!" Yet, for their part, government representatives complained that business people are often unaware of the many forms of support available to them from regional government. In all four regions, government has developed internet-based methods for disseminating information relevant to business. This of course reinforces the one-sided nature of the communication between government and business, but overcomes some of the physical and organizational barriers to communication. It helps fill the information vacuum identified by many of our respondents as a serious barrier to business development, the fact that business frequently lacks knowledge of government's plans.

While the growing use of internet technologies--web portals, blogs, e-government-- does not overcome the problem of poor feedback and the absence of collective action, it does improve the information environment for business. Several of our respondents from regional governments expressed hopes that it would stimulate entrepreneurship and expressed impatience toward businesses that did not avail themselves of the new resources. An official from the regional government in Krasnoyarsk commented that: "From year to year, the number of entrepreneurs who come to us for help, and receive it, is growing. In early 2005 the number of such requests was numbered in the hundreds, now it is up to tens of thousands. So the information on our [internet] portal is spreading rapidly, although not as rapidly as we would like. Still, entrepreneurs, in some cases through word of mouth, are beginning to use this resource more."

A respondent from the executive branch in Perm' declared: "In fact, everything is fairly accessible--if you don't use the internet, you aren't an entrepreneur. If you are on the internet, you know there is a site called g2b, it's our own site, go and take a look at it. You understand? You could get support because you want to get it, you believe in it, you look for it, you find it. Whoever says that no one is helping him is just creating barriers. Those are people who either don't want to find out about support, or have a skeptical attitude toward the entire surrounding world." Another executive branch official from Perm' told us: "On our portal there is a whole section, an internet-receiving office. They ask questions, so go take a look at them first, and you will find everything you need. But, no, they say, we don't want to go searching for anything, we would rather ask our questions. It's the same answer for ten identical questions. Likewise I have been working for many years as a volunteer consultant for the Irkutsk internet portal. The same thing happens there. It's not a regional phenomenon. In Irkutsk we have a standard line of abuse in response: 'what, have they gotten rid of google.ru?'"

At the same time, a number of respondents expressed doubt that the use of internet channels met the real needs of business. An acerbic business leader from Kirov commented: "So that [the internet portal] is not an instrument that could...It could be used to straighten out your stockings. It can't do anything else. The only thing it could do, given a great deal of desire and effort and diligence, would be to collect firewood. What could it do? It could pick up fallen twigs off the ground. But that is beneath it [*zapidlo*]. And accordingly it turns out that nothing happens. But then all of us say, 'oh, look, Masha Gaidar has a blog.'³⁸ That's it. Everyone has started using LiveJournal. They've all gone into LiveJournal. And that's it."

A business person from Perm' said: "Chirkunov is the first governor to be a blogger. At

³⁸ Maria Gaidar served as deputy governor in charge of social policy until summer 2011. She is the daughter of the late Egor' Gaidar, architect of Russia's radical economic reforms in the early 1990s.

one point, perhaps half a year ago, he published in his blog information on the average pay of doctors. According to his figures, the average pay of a doctor in Perm' was 26 thousand rubles. People attacked him on his blog, there were almost 500 responses, whole threads opened up, and he replied: 'those that don't understand basic facts have brains stuffed with nonsense' (*zaprofilennye mozgi*)."

A businessperson from Perm' complained that navigating the regional website was too time-consuming: "they think that all they need to do is to develop the internet. Just put all the information on the internet. But not all small businesses have continuous access. They don't have time. They are working and trying to feed their families!"

A business person from Voronezh complained that the internet cannot make up for basic infrastructure needs: "After the wildfires [summer 2010], the [federal] minister of communications visited and promised to install internet access in the region. I thought: 'What, have they just dropped down from the moon?' People asked him and the governor a question: 'Will you build us a road? Some houses burned down, and the bricks were left. Why not use a bulldozer to clean everything up and lay a road?' People wanted to build a road out of those bricks so that vehicles could drive on it. But instead, here comes the governor and says, 'We'll build you a three-lane internet.'"

Generalizing, it appears that the reliance on informal institutions for consultation and on internet technologies impedes the development of formal institutions for linkage between government and business. Governors prefer issue-by-issue interaction and web-based business services to either parliamentary or corporatist structures that would commit them to defined rules for decision-making. Ad hoc consultations do not give organized interests set rights of representation and participation in policy making. Cooptation and informal consultation

therefore work at the expense of formal rules for decision-making. Yet at least some of the reason for the persistence of this state of affairs is the low cohesion of business associations, whose leaders, given the high barriers to collective action and the resistance to broader formal participation on the part of rulers, find it less costly to cultivate personal, often cronyistic, relations with policy makers than to reshape the institutional environment. The same tendency is still more pronounced with respect to organized labor and political parties.

The Dilemma of Growth versus Redistribution

All four regional governments seek to pursue a pro-growth strategy without radically reducing social welfare spending. In a rich region such as Perm' or Krasnoyarsk, where a number of enterprises proved viable after the transition, governors can work to attract outside investment into existing enterprises, while developing new enterprises to boost tax revenues and absorb labor released from over-staffed state enterprises. Poorer regions such as Voronezh and Kirov, with older populations, a larger rural sector, and many non-profitable enterprise, face a tighter fiscal environment. Their efforts to maintain their expensive system of social policy commitments while supporting local businesses impose a relatively heavier burden on taxpayers. Richer regions can devote a larger share of their budget to measures of support for regional business without sacrificing their obligations for social protection. Thus there is a positive correlation between regional gross output per capita and the share of the regional budget spent on measures of "economic policy" (a broad category in the budget code which includes both direct measures of support for enterprises as well as spending on administrative bodies that regulate and manage economic resources). Across all the regions, the Pearson correlation coefficient between the share of the budget devoted to economic policy and adjusted gross regional product

per capita is .57 (sig = .0000), while the correlation between the share of the budget devoted to social protection and gross regional product is weakly negative ($r = -.27$, sig = .016). Meanwhile, consistent with our premise that there is a trade-off between measures to support the economy and measures to support social spending, there is a strong negative correlation between the share of the budget devoted to all forms of social spending (including education and health care, as well as social protection) and spending on economic measures ($r = -.68$, sig = .0000) and a weaker but still significant negative correlation between economic spending and spending on social protection alone ($r = -.42$, sig = .0001). Figures 1 - 4 illustrate the patterns.

The negative correlation cross-regionally between the shares of budget spending going to economic support and social support reinforces our contention that within each region, governors face a trade-off between improving the well-being of vulnerable strata and increasing assistance to firms. In richer regions, this dilemma is less acute, yet the fact that the relationship between social spending and regional development is much weaker than the one between economic and social spending suggests that, even in poorer regions, governors adopt strategies based not only on the state of the economy, but also on their own policy priorities.

Figure 1:

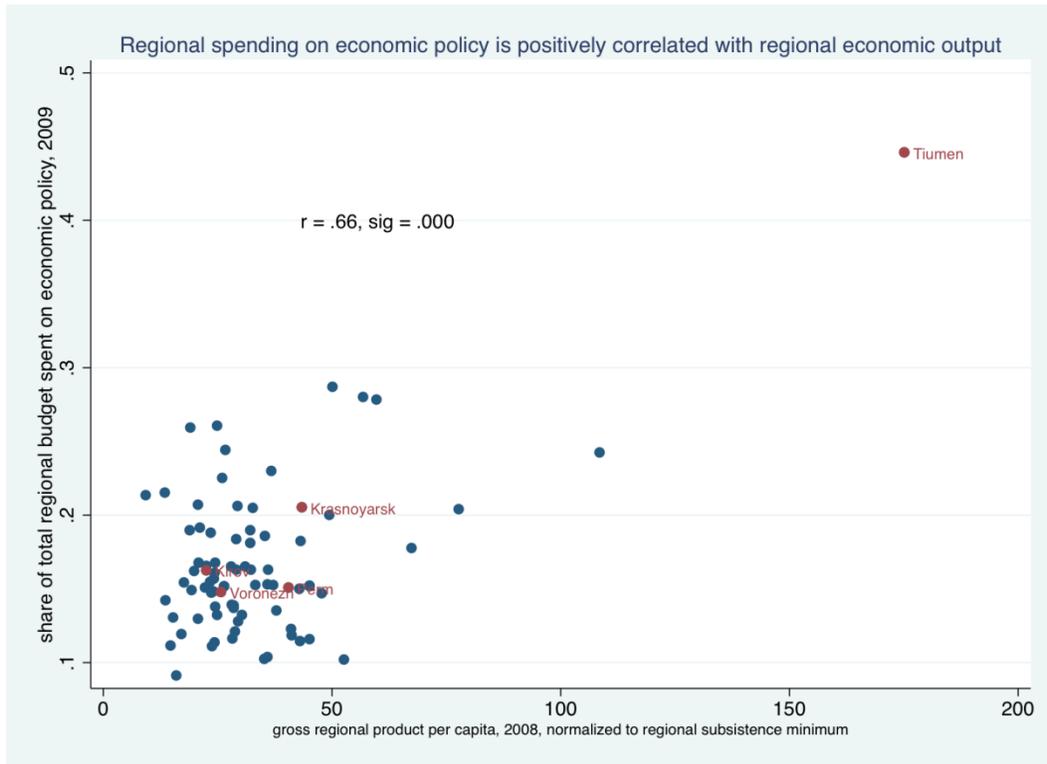


Figure 2:

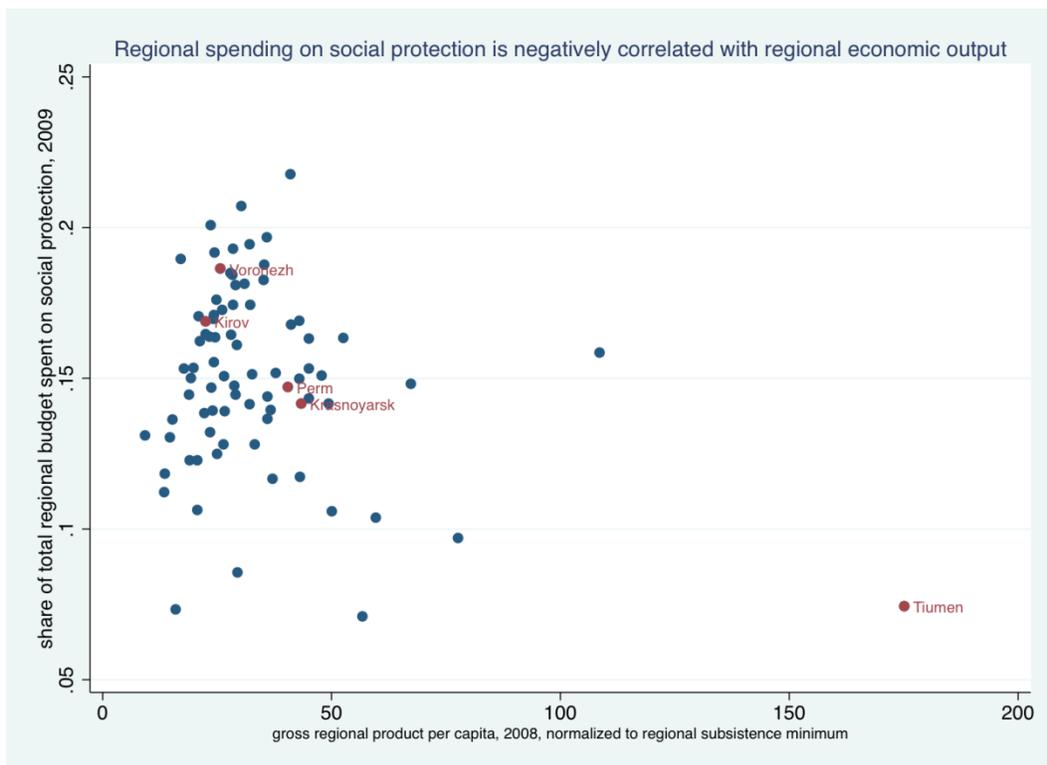


Figure 3: There is a strong negative correlation between economic and social expenditures as a share of the regional budget:

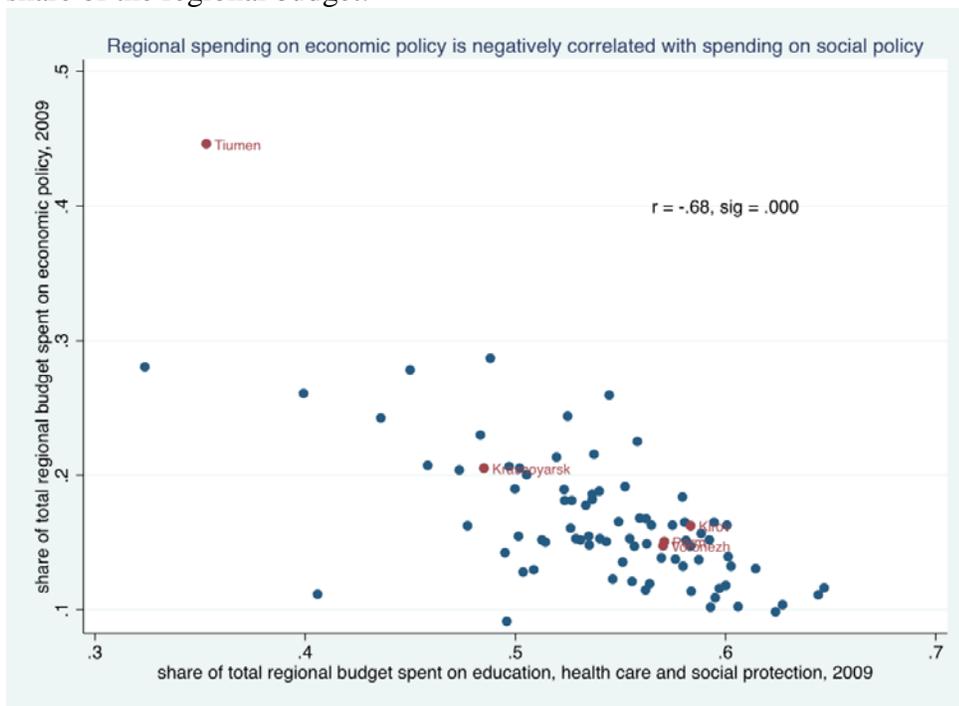
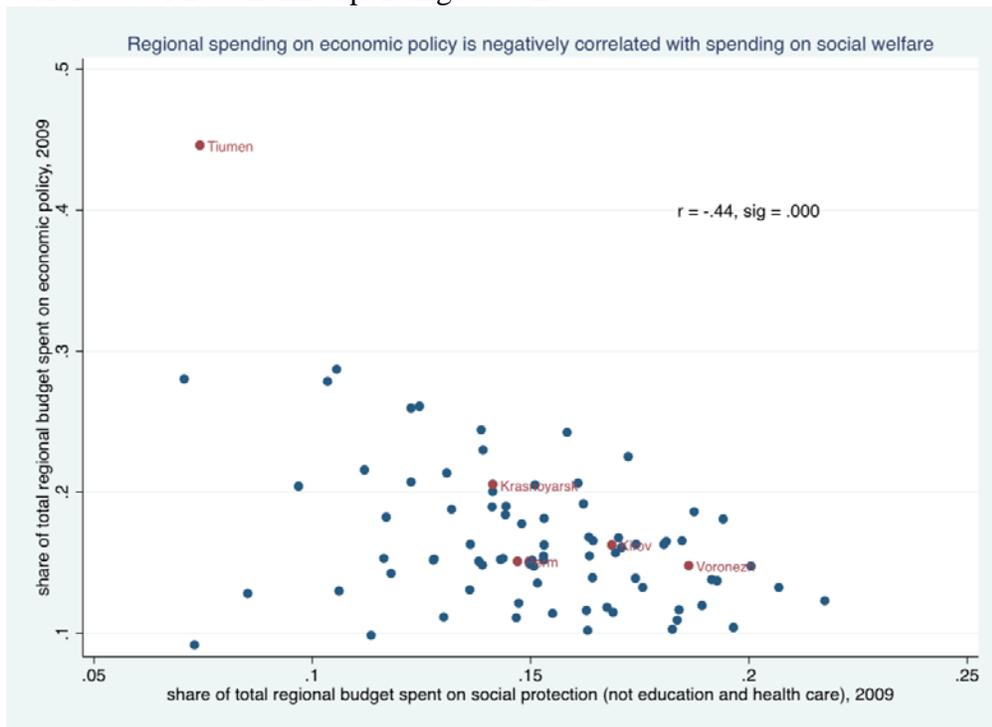


Figure 4: Social protection exclusive of education and health care spending is negatively correlated with economic spending as well:



Commercialization of Public Services

Governments seek to resolve the trade-off between social support and economic development in various ways. In all four regions, governments are looking for ways to place once-public services on a commercial footing. This occurs in both formal and informal ways. For example, some are placing more elements of the health care system on a private, for-profit basis and encouraging more private schools to open up while closing outlying rural state schools and clinics. In Perm', the governor gave a significant salary increase to the top echelon of educators and researchers (doctors of science, full professors) as an incentive. Informally, government officials wink at the prevalent practices by which doctors, teachers, and other public employees exploit their official positions to earn money on the side.

A business person from Kirov said: "Our diagnostic centers now are mostly private. Doctors who are employed in state polyclinics work in these diagnostic centers. The best ultrasound clinician, for example, is a woman. She works in the Euro-Med center, but her main place of employment is the polyclinic in city hospital number 1. I am assigned to that hospital. Does it make sense for me to go to that hospital? It is more convenient for me to reach an understanding and go to the hospital and pay her directly."

An expert in Voronezh said: "There is commercial medicine. It is developing in our city. There are alternatives. There is ambulance service, in fact several of them are working. Even people of modest means prefer to use their services, because they come faster and with full equipment, a group of doctors comes. It is not cheap, but is worth it. This sphere is developing, and is seeing revenues."

The head of a project for developing entrepreneurship in the regional government in

Perm' told us: "Our governor since 2007 in meetings with business propounds the idea, which [President] Medvedev recently put forward, that the state should withdraw from particular spheres, leaving niches to entrepreneurship. Including education. And private schools should be on equal terms. Budget schools should cease being fully financed from the state budget, but should go over to a format of economic institutions and obtain a state order, fight for it." Governor Chirkunov has made the commercialization of educational services a priority. As a political science professor at a regional university there put it, "His chief verb is 'to sell.' 'Sell, sell, sell'. Even last year when he congratulated us on the Year of Science--we have these governor's receptions--although he had a prepared speech, he, apparently, was somehow struck by a thought and said 'We have to learn to sell our brains.' And that inspired him so much that he repeated it five times or so in the course of his rather short speech."

Of course there is a good deal of corruption as teachers, doctors and other public sector employees take advantage of the hybrid economic system:

A businessperson in Voronezh commented: "teachers and doctors feel bad, and sometimes resort to theft... They are very corrupt, their wages are low, they get some grants, but not much. A lot of money is stolen, a lot of money is taken in bribes. An ordinary teacher, of course, cannot steal, but those who are in management and administration, do steal. The others take bribes, that is, I think that they live badly."

A representative of the executive branch in Perm' said: "In the past a doctor used to sit calmly under the protection of the state, surrounded by breakdown, with no medicines available, and as a doctor things might be bad for him, but the fact was that he was important, that he was the only way someone could get help, that he could make a call, he has contacts, he could send

people here or there. He controlled scarce goods and services, such as an examination or a hospitalization. The system adapted itself over the years. That is, the worse things are all around, the better for them personally."

An expert from Perm' comments: "Teachers are simply marginalized... Their wages are hardly above 11,000 rubles plus the pension--which varies. And they have to live on this. They are dissatisfied. At the same time, they are readily mobilized and coopted by our United Russia."

A representative of the executive branch in Perm' commented: "Just go out to one of the districts, to the central district hospital. There will be a single surgeon, who considers himself a demigod, because it is a long way to the nearest alternative hospital. People will come to him regardless. No one would fight or confront him. He can allow himself anything. If he were urged to do something, he could refuse. He is the only one in his position. So this is an extremely difficult issue and the most the state can do is to determine clear rules of the game and not change them."

A representative of the legislature in Krasnoyarsk commented: "There was a period in 1999 and 2000 when budget sector employees were not paid for six months at a time, and people found ways to earn money however they could: teachers from parents, doctors from patients. Now everybody is earning this way but the quality of service has not improved. I can cite an example from my district: when I convert the status of a town from rural to urban, public sector employees receive 25% more in pay but the quality does not go up. People believe that they are already working well enough that they should earn more. Moreover, the habit of extracting money from parents and patients has continued. So I don't know how that fee-for-service principle is affecting things."

To some extent, regional governments try to mitigate the redistributive dilemma by using

social welfare policy to create incentives for investment in human or physical capital. Policies aimed at stemming the flight of the young and educated and raising birthrates--but without increasing dependency--were a recurrent theme of our interviews. An example is Perm's "Mama's Choice" program to replace day care centers with cash income supplements to new mothers. The idea was to alleviate the problem of overcrowding and long waiting lists for spaces in day care centers by giving mothers income supplements so that they can stay home and take care of their children or hire care-takers. A representative of the executive branch in Perm' told us: "We offered mothers compensation to hire nannies, as an alternative to day care facilities. We succeeded in ending waiting lines for day care facilities, but at five, all children must attend kindergarten and receive preparation for school. Children from a socially-dangerous situation, impoverished families, are unable to receive a subsidy and are obliged to place their children in day care. That is our own law."

But, despite the legislation's intent, some families are said to be misusing the program. An expert said: "The governor is making his policy decisions based on his market orientation, because he is proposing supplements to mothers who refuse to send their children to day care and sit at home with their children. There is a lot of publicity about this. Film clips about how mama is happy are shown in every advertising break on local TV. There are of course some hidden problems with this, because children from poor families, lower classes, use this money not at all for the child. The money goes to consumption, or is drunk away, and the child is left with a minimum of contact with other children, which he could have received in day care, because there they do teach something."

There are other problems as well. A local political scientist commented, "So on the one hand you can say, there it is-- "Mama's Choice." A woman works, the waiting lists have come

down, and in several districts they have disappeared, but at what price? Children go to unlicensed day care centers into overcrowded groups." Another expert noted: "To tell you the truth, I have not heard of any construction of new day care centers or particular complexes. Even the playgrounds for children are very few in number, aquaparks are only just getting ready to be built, so where a mother with a child can go, I don't know. Nowhere in particular. There aren't any children's centers, recreational complexes, big day care centers, institutions. None of that is visible."

Another example of an effort to use social policy for economic development purposes is the program (also encouraged by President Medvedev) to pay out unemployment benefits as a one-time benefit so that a recipient can open a small business. The vice-governor in charge of social policy in Kirov explained that: "all the programs that I [am running], programs of the social sphere, they are purely directed toward stimulating entrepreneurship. People are opening auto repair shops, manicure salons. People can get a year's unemployment benefit in advance."

In Voronezh, the chief editor of a newspaper observed that: "you can't call supporting the middle class a goal of the regional authorities. The principal policy comes to trying to rehabilitate that which can be rehabilitated and lifting up that which will bring a good return."

Still, overall, social welfare benefits represent a net cost to the region and often hinder the development of market competition in public services. By subsidizing the services provided by state monopolies such as utilities companies, social spending often exacerbates rent-seeking and corruption by service providers, and moral hazard on the part of the population. The policy in Voronezh to subsidize housing rent and utilities rates for the poor is an example of a policy that helps perpetuate the inefficiency of the public utilities services, which raise their rates without

modernizing infrastructure. A social scientist from the regional state university noted: "Our nascent middle class has problems connected with the rising rates to pay utilities and other services. There is a serious worsening of their position. The rich don't care and the poor receive significant compensation. It turns out that the latter pay 10-15% of their income for utilities, and the state pays the rest. That's a regional program. And the middle class is not classified as the poor and bears an increased burden. In effect, the poor are improving their situation and the middle class's situation is worsening. Likewise the introduction of additional fees and penalties worsens the positions of the middle class."

The Dilemma of Government Subsidies

A number of respondents declared that subsidizing housing, utilities and other public services has some unwanted consequences, including perpetuating poverty and dependency. A representative of the legislative branch of Krasnoyarsk commented: "Let's acknowledge that this problem affects the whole country. The problem is that we have too many social subsidies. We have too many social programs that assist people, for instance in paying their utilities. We have construction of housing for the poor, those living in dilapidated housing. But dilapidated housing is occupied by people who do not take care of it. These programs work as follows. We build the houses, but hobos move in, rather than normal people who also live in municipal housing and really try to keep it up, because their housing is not dilapidated and under federal law they are not eligible to move into the new housing. Though for the sake of justice, it would be necessary to move those who actually work and actually live into the new housing, rather than those who merely drink and have babies...."

An expert from Perm': "Pick up any newspaper. I am amazed that in the remote

countryside, whole columns or half columns of the newspaper list job vacancies. Can you imagine? I was surprised. And that is an indicator. At the very peak of the recession. And that is somewhere in the North, in some small town, like Dobriyanka. I was simply amazed. 'Needed', 'needed', 'needed.' Meantime, there are lines of people at the Employment Office. People come there and sign up. I don't understand the logic of those people. Why are they registering? You can find a job here, here or here. And they register at the employment office and sit at home. And get 4000 rubles [per month]. And I understand the thinking of those people: why go to work for 5000 if you can get 4000 for doing nothing?"

On the other hand, it is not only the poor who receive subsidies from government; business does as well. A business person in Perm' who is also editor of a local business newspaper declared: "We have to help small business! All our enlightened ministers, they all, in line with (Governor) Chirkunov avoid the word 'help,' they say 'we have to develop' but not to help; business must take care of itself...But in our case you have to help. Business is like children--we have just barely entered into market relations, you have to learn how to do it, we don't have that upbringing, the conditions are not created, the laws are not enforced."

The economic crisis of 2008-2009 intensified business demands for subsidies and credits from regional government. Substantial federal funding was also distributed to regional programs to maintain employment, stimulate entrepreneurship and subsidize businesses affected by the recession. In Kirov the region spent one billion rubles to subsidize bank credits for businesses. The board chair of a regional business association in Kirov, who also chairs a standing committee in the regional assembly, noted:

Our programs of support are directed not toward big business but toward medium and small business as well. Money has been appropriated, there is a special fund, and we very substantially assisted several enterprises. That's not words. We increased aid several times over. Including through the use of federal funds, including the funds that came to support employment. Moreover, through the employment program we also helped, when we gave money to support jobs, that was also a large matter, that was a colossal thing that was done....a billion [rubles] in resources went to guarantee the oblast'. In Russia, in order to survive, credit is needed, and a bank demands collateral, but it is meager and the bank has no need for such collateral. The person goes to the commission that we created with a proposal and needs credit. The oblast' gives a guarantee to the bank and the bank gives the credit, we spent almost a billion on that. That program continues to exist but this year we won't allocate that much. But last year, the most difficult year, there was a billion.

An official of Kirov oblast' in charge of supporting entrepreneurship stated: "Definitely, there are programs. Something like 42 million rubles in oblast money was allocated for the support of small business, legislation was passed in support of small business, we brought in federal money. But in the end, it helped only modestly." The business community has also pressed successfully for the governor to roll back rate increases for electric power and leased office space. Administrative intervention in service provision of course does not solve the problem of inefficient, uncompetitive utilities monopolies. Governor Belykh himself notes the impossibility of upgrading regional infrastructure: to bring the road network up to code would cost 63 billion rubles while the regional budget is 43 billion. To modernize the housing-utilities

sector would cost 57 billion.³⁹ In Kirov, therefore, as elsewhere, it is considerably cheaper in the short run, and less politically costly, to use administrative controls to limit rate increases for the services of an aging Soviet infrastructure than it is to create an efficient system--public or private--for providing basic services.

Similar programs to assist regional business through subsidies and credit guarantees exist in all four regions. In Perm' krai, the government-sponsored "Center for the Development of Entrepreneurship" which manages a program to guarantee bank loans for small business and runs eight different programs to subsidize new firms. Krasnoyarsk has a business incubator. When the new governor took office in 2010, his first official act was to visit it. Krasnoyarsk also subsidizes businesses that hire additional workers.

In all four regions, respondents also told us that government was trying to simplify procedures for registering new business, adopting the so-called "one-window" system by which entrepreneurs would only have to deal with one office to obtain all the necessary clearances to open a business. Businesspeople were generally very critical of the effectiveness of these efforts, however.

Regional governments often offer to lower taxes on business--particularly the imputed tax on small business that replaces the profits and payroll taxes-- in order to encourage investment. The chairman of a business association in Voronezh was proud that his region had experimented with lowering and simplifying business taxes in the mid-1990s, earlier than most regions. "Then there were about 17 taxes that we paid....I went and reached an agreement with the governor. We created a commission with about 30 people: from the Ministry of Finance, the Tax Police, the *militiia*, the Pension Fund, some entrepreneurs. We met for eight months once a

³⁹ Belykh, "Chto mozhet sdelat'."

week and persuaded him. How? The chief task was to bring the entrepreneurs out of the shadows so that they would pay money into the budget. We then calculated that about 70% of businessmen were avoiding the tax service. A year went by, and the vice-governor for the economy proudly reported that 'We are one of the few regions to have adopted this experiment. Entrepreneurs began to pay three times less, but the revenues rose 3.5 times, and the number of registered entrepreneurs increased three times'."

The head of a department for promoting entrepreneurship in Krasnoyarsk krai told us: "We are freeing entrepreneurs in high-priority areas of activity from various regional taxes, the transportation tax, the tax on property, and so on. Generally, there are radical proposals, including from deputies in the regional assembly, to free small and medium business entirely from all taxes for a particular period, as was done in Germany. Let them develop at first, and then, if they survive and get up on their own two legs and begin to develop actively, then we can deal with the question of taxing them. So far, the leaders do not have that position."

These efforts are encouraged by federal policy. A member of a business association in Krasnoyarsk saw some improvement in conditions for business as a result of federal pressure: "in the last few years, as a result mainly of measures adopted by the federal government, the institutional milieu, mainly as a result of legal measures that have been adopted, is beginning to change. The reason for such an attempt at development and support was the mandatory accountability of governors for measures connected with the development of small and medium business. Federal money began coming in, co-financing was introduced, accountability appeared, work began to be done. Dmitrii Anatol'evich [President Medvedev] is now speaking about innovation development, this is also having an effect in this direction."

Community Grant Programs

In all four regions there are also efforts to stimulate economic development at the local level through grants competitions under which local communities submit proposals for projects to the regional government for co-financing. In Krasnoyarsk a deputy in the regional legislature declared: "There should be a policy such that if you work better, you receive more. In that connection we have a very good grants policy program in the region. It was introduced under [former governor] Khloponin. Grants for maintenance, grants for educational and cultural facilities. People began to receive real money, people began to work and to receive real money, those who write the grants and really can come, and you can go to schools and sports facilities, computer classes, capital repairs in many territories. So this program really stimulates people, those that want to work. So you can calmly visit a place and if they start to complain that they are lacking something, you can ask them whether they wrote a grant. If you want to work, you will receive it."

In Perm', the grants program for municipal projects uses a combination of regional and federal funding to encourage projects that will stimulate entrepreneurship. In Kirov, consistent with Governor Belykh's strong emphasis on providing incentives for self-organization on the part of civil society, there are two programs aimed at encouraging community development. In one, towns hold referenda on levying taxes to pay for specific projects, such as maintaining local cemeteries or building a recreational facility. The oblast budget matches local contributions ruble for ruble. Over half the towns in the region are participating in the program. Under another, conducted in association with the World Bank, communities hold town meetings to decide on local priorities. For each project, they draw up a business plan specifying how the project is to be carried out. In many cases, the project involves submitting a grant proposal to the

oblast budget, which subsidizes as much as 85% of some projects. As Belykh explains: "In fact, the co-participation of citizens is not significant in an absolute sense, but it is important as a principle, in order that there not be a feeling of getting something for nothing (*khaliava*)."⁴⁰

Conclusions

Studies of the varieties of capitalism demonstrate that there is a tendency for political and economic institutions in advanced industrial democracies to be complementary. Scholars distinguish the "liberal market economy" model--characterized by highly competitive markets for labor and capital, limited public provision of welfare and training, and competitive, majoritarian political institutions--from the "coordinated market economy" with its emphasis on bargaining and coordination among business, labor and government, reliance on consensual decision-making, and high level of income security.⁴¹ Our case studies suggest that, despite some differences in emphasis, all four regional governments are pursuing hybrid strategies of regional development. These combine some features of the old socialist statism (such as the administratively determined rates for services by state utilities providers, the authoritarian patterns of decision-making, and the universalism and regressive nature of social entitlements) with elements of a somewhat skewed corporatism by which business interests are given access to policy making, together with elements of a liberal market-oriented economic policy of low taxes and low redistribution (as seen in the push to commercialize and privatize public services). This hybrid model of politics and economics allows regions to avoid radical and potentially destabilizing shifts away from the universal social welfare system of the Soviet regime while slowly introducing elements of market competition into the labor market and market for social

⁴⁰ Ibid.

⁴¹ Hall and Soskice, *Varieties of Capitalism*.

services. At the same time such a strategy is costly and inefficient, and preserves ample opportunities for rent-extraction and corruption. It also perpetuates tendencies toward paternalism and dependency on the part of the public, including business.

From the standpoint of institutional development, what stands out from our case studies is the lack of long-term strategic thinking on the part of either government or business. We began by asking whether regional governments had any strategies for developing a middle class in their regions, understood as a stratum of individuals, whether in the market or public sectors, oriented toward investment in productive effort yielding long-term payoffs, such as the accumulation of human capital or investment in long-term financial assets. For the most part, regional officials do not see it as their goal to build a large regional middle class. They do, however, see the task of expanding the business sectors of their regions as urgent and, within the limits of their abilities, they are adopting policies aimed at doing so.

We have argued that regional governments, like national governments in Russia and elsewhere, face fundamental choices in their strategies for regional development. Creating a climate favorable for business investment comes at the expense of resources needed for other purposes, particularly for redistribution in favor of dependent strata of the population or for the subsidies and credit guarantees that enable local firms to weather difficult economic conditions. The redistributive dilemma is therefore not just between support for the productive sector and support for the dependent strata, it imposes choices over the relative priority of different sectors of the society--the poor and vulnerable; the business sector; and the public sector. The fact that regions have managed to raise the base salaries and associated benefits for public sector employees indicates that the redistributive choices faced by governors are often resolved in favor not of the poor nor of business, but of the public sector--which is often deeply intertwined with

business. Moreover, within the public sector, some groups are clearly at a disadvantage. Ill-paid teachers and health care workers compensate for their lagging earnings by finding ways to extract fees and bribes from the general public. Low tax collections, inefficient public utilities companies, and weak financial markets all make these redistributive conflicts more acute and the trade-offs more difficult politically for governors than would be the case if tax receipts were more robust (which would occur if employers reported and paid taxes on a higher proportion of their actual earnings), if utilities companies provided public services cheaply, and if financial markets could handle bond issues for infrastructure development bringing long-term returns. The extremely short time horizons of economic agents reinforce these redistributive dilemmas.

So too do the institutional failures of the post-Soviet environment. Of all the sectors of society, it is business--the one fully new sector to arise in the post-socialist society--that has some capacity for self-organization and self-representation. Large business associations are reasonably effective at the federal and regional levels in achieving their policy goals. Governments turn to business associations for advice, information and support, while the business associations seek to influence policy. Yet, at the regional as at the federal level, the effectiveness of business is limited. Studies of advanced industrial democracies suggest that the capacity of business to unite around common interests tends to be greater where the bargaining power of organized labor is greater.⁴² The ability of peak associations to constrain their members and enforce agreements is affected by the strength of their rivals in redistributive conflicts in the labor market. The fact that Russian employers still have a great deal of discretion

⁴² Torben Iversen and John D. Stephens, "Partisan Politics, the Welfare State, and Three Worlds of Human Capital Formation," *Comparative Political Studies* 41:4-5 (2008): 600-637; Torben Iversen and David Soskice, "Distribution and Redistribution: The Shadow of the Nineteenth Century," *World Politics* 61:3 (2009): 438-86.

over the terms of labor contracts with individual workers⁴³ reduces incentives for workers to bargain collectively or for businesses to unite in bargaining with labor. Labor's low organizational capacity leaves business with only weak incentives to become a more effective collective actor. In turn, the fragmented character of both labor and business associations allows the state, even in the ostensibly market-oriented post-communist environment, to remain the dominant player in setting economic and social policy.

Institutional development in the electoral and parliamentary arenas is still more stunted. United Russia enjoys a near-monopoly on political organization and, in the absence of effective opposition, therefore also turns to the state to protect its dominance rather than competing for popular support or loyalty. Legislatures and regional branches of United Russia therefore serve as sites for parochial lobbying by business firms rather than institutions facilitating collective responses to public problems.⁴⁴

The absence of a competitive institutional environment therefore--paradoxically--inhibits coordination on the part of organized social interests, whether these are business, labor, agricultural, or professional groups, or segments of the public mobilized in support of competing parties. Without effective coordination achieved through bargaining on the part of opposing interests or ideologies, governments operate in a kind of institutional vacuum. It is not only that the information environment suffers from the absence of regular competition, bargaining and collaboration. Isolated and detached from society, the state cannot induce commitment to long-term investment on the part of economic and social actors. Collective agreements prove to be unenforceable because business and labor are unable to hold each other to their terms and neither

⁴³ Vladimir E. Gimpel'son and R. I. Kapelishnikov, Eds. (2007). *Zarabotnaia plata v Rossii: evoliutsiia i differentsiatsiia*. Moscow, Izdatel'skii dom Gosudarstvennyi universitet Vysshiaia Shkola Ekonomiki.

⁴⁴ The current efforts to improve United Russia's electoral prospects by creating a "united popular front" for affiliated pro-regime organizations only reinforce the party's near-monopoly on access to power.

is able to restrain the state from violating them. This dilemma preserves a low-productivity, low-security equilibrium in which neither workers nor businesspeople can be confident that investment in skill acquisition or complex, innovative technologies--investments that would yield payoffs only over the long run--are safe. Resolving the redistributive dilemma at a higher-productivity equilibrium would be possible if institutions for coordination within the business and labor sectors were more effective and if there were higher levels of cooperation among them and with government. Then actors might be willing to pool the costs and gains from joint efforts to invest in infrastructure development, improved labor market regulation, training programs that would match the skills of workers to the demands of new productive technologies, and financing for region-wide development plans. A strategy of building a middle class oriented toward a long-term stake in the economic development of a given region would be one way of alleviating the paralyzing redistributive dilemmas faced by the regional governments. For the present, however, regional governments have not posed this as a goal.