

Putin's Russia: Is It a Doable Project?

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Introduction

The new Russian president repeatedly has claimed that the economic revival of Russia is the principal goal of his administration. After an initial period of uncertainty, the policies that Putin and his aides have chosen to improve the economic performance of the country have become clearer. They are (1) a “strong state,” able to enforce the rule of law, and (2) a liberal economic policy.

Following a drastic output contraction during the first decade of post-communist transformation, Russia has experienced considerable economic growth (ca. 20 percent of GDP in 1999–2001; see MERT 2002). The projections for 2002 are in the range between 3.5 and 4.5 percent of GDP increase. The unemployment rate dropped from its peak of 14 percent in early 1999 to 8.5 percent in 2001 (OECD 2002). Inflation also has been reduced.

However, skeptical observers claim that the impressive results of 1999–2001 are due to the ruble devaluation in August–September 1998 and relatively high world prices on crude oil and other natural resources. The ruble devaluation stimulated import substitution by Russian manufacturers and, consequently, employment of idle production facilities.¹ At the same time, high oil prices created overprofits for Russian exporters and amplified the revenue of the federal budget.

To what extent should the recent improvements in the Russian economic performance be attributed to Putin's policy measures?² This question relates to a more policy-relevant one: Can the combination of the “strong hand” government with liberal policy serve as the means of economic recovery in the near future?

The main idea of this paper is to test the viability of Putin's project, combining “strong hand” government with liberal economic policies as a means of economic revival, against the latest empirical data from Russia. Recent empirical research highlights the diversity of policies and institutional frameworks in Russian regions through the 1990s and at the beginning of this decade. The outcomes in terms of gross regional product (GRP) change, investment, and consumption

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vary significantly as well. Can the interregional variance in economic performance be attributed to the policy factors upon which Putin's administration strives to capitalize?

The next section presents an overview of "Putin's project" (that is, two dimensions of the policy of the new administration): government by a "strong hand" and economic liberalization. Then, to address the question of whether these two trends can contribute to the aspired economic revival, this research draws on the pertinent literature and international experience. The following empirical sections address the above questions as the hypothesis that the combination of the "strong hand" government with liberal economic policy has been instrumental for socio-economic development in the post-1998 Russian setting. This hypothesis is tested against the empirical data from seventy-eight regions of Russia.

Two Dimensions of "Putin's Project"

"Strong Hand"

Since Putin became prime minister in 1999, the Russian government has implemented several measures to discipline regional and local authorities. First, seven federal districts were created in May 2000 to supervise the implementation of federal legislation in the regions. Second, the legislators vested the president with the authority to suspend governors from their office if they refused to comply with federal legislation.³ Third, as a result of several amendments to the Law on the Formation of the Federal Council, governors and chairpersons of regional legislatures had to leave the Upper Chamber of the Russian parliament by January 1, 2002, and were replaced by appointed or indirectly elected regional representatives. Simultaneously, the share of the regional governments in the Russian consolidated budget shrank in 1999–2002, after considerable expansion in the previous years.⁴ Then, the new political party law and pending amendments to the electoral legislation aimed to secure the key role of federal political parties in electoral campaigns, including those at the regional level.⁵

At the same time, the president reportedly has been one of the key actors in the crusade to "retrieve," as he has said, the control over mass media from the hands of the oligarchs—representatives of Russian big business who (mis)used their media empires to profit from their political influence.⁶ Putin's opponents portray the campaign in a different way. They contend that the president strives to monopolize the Russian mass media to secure his own power and reelection in 2004 and to sound the alarm about the freedom of speech situation in the country.

The control over the mass media has been instrumental in translating the economic growth of 1999–2001 into high personal popularity for Putin. Public opinion surveys constantly indicate that between 60 and 80 percent of the Russian electorate trust the president and are generally satisfied with his performance. The popularity of the cabinet and the liberal economic policies is significantly lower, however. Public support for the Communists has not vanished. Moreover, the pro-Putin coalition of centrist parties (the "United Fatherland"), which is the

key player in the contemporary Duma, lags behind the Communist Party of Russia (KPRF) in polls (figure 1).

Putin's "strong state" is not synonymous with a complete authoritarian restoration. Liberal opponents call today's Russian political regime a "managed democracy." The government controls the most influential mass media, but cannot prohibit criticism elsewhere. Elections are held, but the administration exercises, although not always effectively, its influence on electoral commissions to get rid of the most "undesirable" candidates. The opposition is not suppressed by force, but its leaders are often influenced by the "sticks" of political ostracism and the "carrots" of prime time interviews on state television.

"Stability" and "growth" are the buzzwords used to justify the constraints on political freedoms and democratic competition. Liberals are pleased with economic reforms. Conservatives are gratified by the "law and order" rhetoric. This broad coalition is unstable, however, and the ruling clique [*pravyashchaya tusovka*] may hope that the economic growth can legitimize the regime in the long run, whether Russia transforms into a liberal democracy, consolidates as an autocracy, or remains a "concentrated poliarchy."

Liberal Economic Policy

Putin's aides declare that public support for the president, centralization measures, and dismissal of media-moguls are all means to reinforce the state. However, they clearly understand that these measures do not secure the aspired economic revival per se; "right" economic policies should translate the capacity of the government

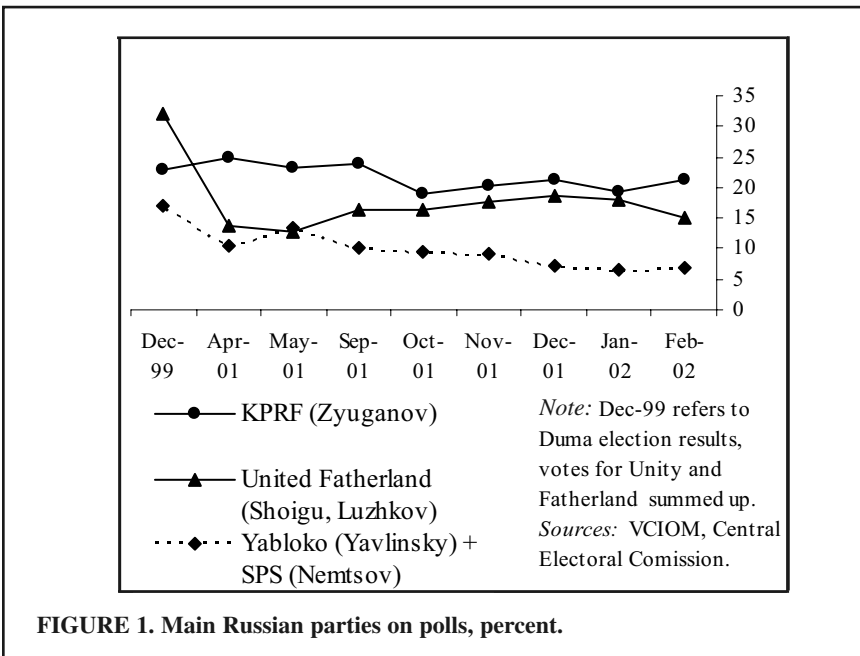


FIGURE 1. Main Russian parties on polls, percent.

into the desirable outcomes. So far, the economic policy of Putin's government has been more proactive than that of Yeltsin's administration in the years following the initial radical reforms of 1992–93,⁷ and considerably more liberal than the current preferences of the Russian electorate.

Among the implemented economic policy measures, lowering the taxation burden and increasing transparency of the fiscal system deserve special attention. The income tax was set at the flat rate of 13 percent. Other taxes were merged to simplify the system (for example, the unified social tax, instead of contributions to several social insurance institutions) or their marginal rates were substantially reduced (for example, a profit tax of 24 percent instead of 35 percent), with simultaneous abolition of several deductibles. A simplified taxation system for small enterprises also is being introduced.

The realization of other liberal projects appeared to be more problematic. The government succeeded in passing a legislative package on the so-called de-bureaucratization.⁸ The legislation has envisioned that the registration of new enterprises should become easier, licenses should be required only for a limited number of business activities, and numerous inspections to control activities should be restricted. However, evidence on the implementation of these legislative provisions is mixed.

Hotly debated are reforms of social security, public services, and the financial system. The parliament generally has approved plans for a gradual transition to a funded pension system with individualized accounts. Municipal services, as well as powerful state monopolies in the natural resource, electricity, and transportation sectors, are among the next possible targets of the liberalization policies. The government has intensified negotiations on its accession to the World Trade Organization.

To summarize, an attempt to combine the government by a "strong hand" approach with economic liberalization has become the main feature of Putin's agenda. The administration seems strongly committed to the economic revival of Russia. One may speculate whether this commitment is due to legitimate concern for the people's well-being, a desire for the regime legitimization, or an aspiration to increase the might of the Russian military in the future. Democracy and political freedoms are excluded from the list of top priorities, however.

This paper does not argue that this prioritization of prosperity over liberty is right—or wrong—from a normative point of view. The purpose of this investigation is to examine the feasibility of "Putin's project." Assuming we accept Putin's priorities, our main question, then, is whether or not this combination can deliver the aspired economic results. The following section presents an overview of the relevant empirical literature, mostly based on international comparisons.

Literature Review

The effect of economic liberalization on economic performance is one of the most frequently addressed issues in research on post-communist transformation. Nearly all empirical studies find a strong association between the progress in market

reforms, and economic growth and other performance variables. However, the nature and shape of this association are disputed. Empirical studies can be divided roughly into two groups: (1) those that claim endogeneity of economic liberalization and performance and (2) those that highlight a positive impact of the liberal economic reforms.

The former group of studies claims that the progress in market reforms and economic development both are functions of certain initial conditions of a country or region (its previous level of development, cultural background, geographical factors, etc.; Åslund et al. 1996; Heybey and Murrell 1999; Krueger and Ciolko 1998; Popov 1998, 2000). Once the initial conditions are controlled, the positive effect of economic liberalization on performance vanishes. Thus, the association between economic liberalization and performance should not be interpreted as a causal link from the former to the latter. This argument conforms to the theory of path dependence in post-communist transformation (Henderson and Robinson 1997; Wallace and Haerpfer 1998).

“There are some indications that the positive effect of political liberalization is not unconditional in the post-communist setting.”

On the contrary, Berg et al. (1999) argue that policy factors are more important than initial conditions for the explanation of the differences in the economic performance of post-communist nations. The authors further maintain that the difference in performance between Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS) can be explained by differences in the implemented economic policy. Havrylyshin et al. (1998), as well as Havrylyshin and van Rooden (1999) report similar findings. Hallagan and Zhang (1999) demonstrate a strong positive effect of “residual reform,” that is, the differences between the actual level of liberalization and the level predicted by a regression on initial conditions.

There is also an intermediate position in the debate on the relative importance of initial conditions and reforms. De Melo et al. (1996, 1997) introduce the concept of “patterns of transition.” They claim that countries with favorable initial conditions *and* advances in liberalization have demonstrated exemplary performance, while other nations have been less successful.

According to the World Bank (2002), the relative importance of policy factors grows over time: “While the initial conditions that prevailed at the beginning of transition were critical for explaining the output decline that occurred initially in all countries, market-oriented policy reforms have played a significant role in promoting subsequent economic growth” (2002, 28). The study estimates that initial conditions explain 51 percent and 44 percent of variance in economic growth in 1990–94 and 1995–99, respectively. Findings by Castanheira and Popov (2000) and Falcetti et al. (2000) are similar.

Those authors claiming a strong impact of economic liberalization on subsequent performance present different views of the shape and conditionality of that relationship. Some argue that the effect of liberalization is robustly positive (Berg et al. 1999; Hernandez-Gata 1997). Others contend that this effect has a non-linear shape, or that it is conditioned on socio-political factors, the level of economic development, or the geographical location of a country.

De Melo and Gelb (1996) find that the relationship between economic liberalization and performance of post-communist countries is close to the classic J-shaped response to policy or institutional changes. Initially, liberalization has a negative impact on output. However, if reforms are sustained and liberalization advances beyond a certain point, economic recovery and sustainable growth will be achieved. The estimated threshold is at approximately .4 on the authors' liberalization index—approximately the level of Russia in the late 1990s. The countries that do not advance their reforms beyond the threshold are likely to experience a continuous decline, resembling an L-curve of the rapid GDP fall, followed by a prolonged output contraction as in some CIS countries (Bradshaw et al. 1998; Lavigne 1995).

Having reported similar findings, Fidrmuc concludes: "Either no liberalization or full liberalization is better than intermediate liberalization" (2000, 8). This argument is supported by the observations that the positive effect of economic liberalization on growth has been stronger since 1995 than in the initial period of transformation (Fidrmuc 2000), and quicker in CEE than in the CIS (Selowsky and Martin 1998).⁹ This perspective also helps to explain why the contraction was relatively low in "non-reformers" Belarus and Uzbekistan, while cautiously reformist Ukraine experienced the longest period of output decline (ten consecutive years, more than any other country in transition).

The effect of political liberalization on performance is a hotly debated issue as well. In comparison to the research on less developed countries of the "Third World" (Sirowy and Inkeles 1990; and Siermann 1998), empirical studies of post-communist transformation are much more supportive for the notion that political liberalization facilitates socio-economic development. Campos and Coricelli (2000) infer that the rule of law and quality of democracy, alongside economic stabilization and liberalization, have been the crucial factors of performance in transition.¹⁰ A stylized fact is presented in the Freedom House report "Nations in Transition" (1999), which compares three groups of transition countries: consolidated democracies, transitional societies, and consolidated autocracies. The former group demonstrated average growth of 4.7 percent in 1997, the second averaged growth of 1.4 percent, and the third showed average decline of 2.4 percent.

There are some indications that the positive effect of political liberalization is not unconditional in the post-communist setting. For instance, until recently, authoritarian Belarus and Uzbekistan considerably outperformed the more democratized countries of the CIS. The GDP decline between 1990 and 2000 was 12 percent and 5 percent in Belarus and Uzbekistan, respectively, while Russia experienced 36 percent of the GDP fall (World Bank 2002, 5). Castanheira and Popov (2000) point out another example. They compare Chinese and Russian

economic performance in the 1990s and explain the well-known difference by arguing that, in comparison with weak democracies, strong authoritarian regimes have better chances to secure the rule of law.

Some studies relate the positive effects of political liberalization to cultural factors and changes in the elite composition. According to Hillman (1999) as well as Hillman and Ursprung (1999), liberalization has a deteriorative effect on economic performance until a cultural adaptation takes place. Thus, the contraction should be longer in the societies where the socialist behavioral patterns have taken deeper roots, such as in the CIS. Shleifer (1998) makes a similar point concerning the elite change. He explains the better performance of Poland in comparison with the Russian demise by the higher turnover rate in the personal composition of political leadership in Poland.

Opposite views on the shape of the relationship between political liberalization and performance are presented by Barro and Fidrmuc. Barro writes: "democracy enhances growth at low levels of political freedom but depresses growth when a moderate level of freedom has already been attained" (1996, 1). His opponent claims that little political liberalization is associated with output decline, while further progress in democratization brings about positive results (Fidrmuc 2000). Fidrmuc explains that the link between democracy and growth is indirect: political liberalization is conducive to economic reforms, while the latter have a strong positive impact on growth; but the marginal effect of political liberalization on growth is weak and rather negative. Thus, the ability of political reforms to propel or impede economic ones is the key.

The Link between Economic and Political Liberalization

Empirical studies demonstrate that the association between economic and political liberalization in the post-communist societies is even stronger than their associations with the desirable transformation outcomes. Dethier et al. (1999) claim that the propensity to implement economic liberalization depends on the level of political freedoms. Findings by de Melo et al. (1996) and Fidrmuc (2000) are similar. In respect to constitutional design of new post-communist democracies, Hellman (1997) infers that presidential governments, which are associated with higher power concentration, are less prone to undertake rapid economic reforms. All empirical studies on post-communist democratization agree that economic liberalization is more likely to be implemented in a more liberalized political environment; but it is unclear whether this relationship is a matter of endogeneity or merely a causal link.

Generally empirical investigations confirm that there are strong positive associations between political and economic liberalization and socio-economic performance. However, there is no consensus on the nature, shape, and conditionality of these links: Are they cases of endogeneity or a causal relationship? Are these relationships linear or not? Do they change their strength or direction over time or in certain circumstances? All these issues are debated.

One can safely assume that post-communist nations with favorable initial conditions had better chances to place themselves on the track of incremental

liberalization in both economic and political terms. Those that did so have harvested better results in terms of economic growth, social security, etc. The most prominent examples are located in the northwestern part of the Eurasian post-communist space (Visegrad and Baltic nations, Slovenia).

The contemporary challenge to students of post-communist transformation is to address the ongoing developments in and elaborate on optimal policies for the countries that are less advanced in their transitions to democracy and a market-based economy and—more than a decade since the Berlin Wall collapsed—still stay in a point of bifurcation. The old question is raised again: Is the “strong hand” of a semi-authoritarian ruler necessary to alter the path of national development from, in terms of Wallance and Haerpfer (1998), the “Eastern transition path,” that is, that of the CIS, to a more successful one?

One may have reasonable doubts as to whether or not there is an answer that applies in any circumstance, independent of a country’s level of development, historical background, recently formed public attitudes, etc. In the absence of a consensus to the above question, Putin’s Russia seems to have opted for the strategy of liberal economic reforms by a “strong hand,” which controls the mass media and enjoys a high level of the electoral support. Can this strategy be the way out of the contraction of the 1990s?

Hypothesis and Operationalizations

If the combination of the Putin-style “strong hand” approach and liberal economic policies is an appropriate recipe for the economic revival of Russia, one can hypothesize that, other factors being equal, economic performance should be stronger in those Russian regions where governors have enjoyed a strong electoral mandate, the state has controlled the mass media, and the economies have been more liberalized.

Empirical Scope

This paper draws on the recent (1998–2001) empirical data from seventy-eight Russian regions. Autonomous districts are not included in the sample because they are parts of other regions and, thus, cannot constitute independent observations.¹¹ War-torn Chechnya is not included because of the lack of the data and her questionable affiliation with the Russian Federation.

The empirical focus is on regional economic performance in 1999–2001—the period after the financial crisis of 1998. Because of the lack of some data for 2001 and the assumed one-year lag between the response variables and economic liberalization, employed predictors account for political and economic liberalization in 1998–2000.

Proxies and Controls

Response variables

Students of Russian regions most frequently use the change in gross regional product (GRP) per capita as the measure of relative performance of a region in economic terms. However, there are several reasons to doubt the reliability of the

GRP measurement (or its country-level analog, GDP) in the post-communist setting. First, it is difficult to estimate economic growth in terms of value added, when prices are as distorted as they were under the communist rule, and remain in many post-communist countries. Second, there are enormous obstacles to the data collection, since a large part of the economy stays in shadow. Third, the GDP or GRP measurement does not capture important changes in the output structure (for example, conversion) when the replacement of huge military production with smaller quantities of commodities for household consumption improves standards of living, but registers as a decline of GDP or GRP (Åslund 2001; Fidrmuc 2000, 4; World Bank 2002, 8).

Nevertheless, this paper presents the results of regression analysis for the regional GRP change (in percent, adjusted to inflation in consumer prices, GROW_ADJ) in 1999, the last year for which the official data are available. However, as more sensitive—and perhaps more reliable—indicators of economic performance, the present study employs the logarithmic transformations of regional foreign direct investment inflows per capita (LN_FDI)¹² and the number of small enterprises per 1,000 inhabitants (LN_SME).

We can consider the intensity of FDI inflows as an evaluation of the regional investment climate and economic perspectives by real economic actors (Broadman and Recanatini 1999). At the same time, empirical investigations demonstrate that FDI is an important factor of economic development in Russia (Yudaeva et al. 2000). Evidence from other emerging market economies is similar. For example, the World Bank concludes: “Important in the recovery of output was direct investment from abroad. These flows are important not only as a source of capital and new technology to modernize industries and extract natural resources, but also as a signal of confidence in the transition to a market economy” (2002, 6).

The development of small enterprises also can be interpreted in two ways. First, it is a sign of a government's market-friendly policy and relatively low corruption (cf.: Berkowitz and De Jong 1998; Popov 2001; Zhuravskaya 1998). It is also a desirable factor per se, which increases competition and people's direct involvement in the emerging economic system (OECD 2002; World Bank 2002). The indicator is calculated as the number of small enterprises registered in the region and normalized to regional population (per 1,000 inhabitants).¹³

The above indicators of economic performance are strongly correlated. Pearson's coefficient (hereafter, “R”) for the bivariate correlation of LN_FDI and LN_SME is .499, which is significant at .001 probability level. LN_FDI correlates with GROW_ADJ (R = .43, significant at .001 as well). LN_SME does not exhibit any significant correlation with changes in the general economic output. Thus, it may be seen as an indicator of ongoing economic reconstruction rather than expansion.¹⁴

Explanatory Variables

On the scale of democratic development, the Putin-style “strong hand,” or “managed democracy,” approach is located between “soft authoritarianism” of the East Asian type and *streitbare Demokratie*, “democracy that can fight for itself” of the

early FRG. The tense competition for electoral support and freedom of expression outside the state mass media explains the difference between today's Russia and Kuomintang's Taiwan of the 1960s and 1970s. The presence of a single predominant political institution (the presidency) and the ability of the government to resort to non-democratic means, such as the manipulative use of the state mass media, distinguish Putin's regime from the liberal democracies of the West.

The similarity to the measures employed by Putin's administration is a desired property of our explanatory variables. Since the control of the mass media and the president's popularity have been among the key features of Putin's "managed democracy," this study uses the following variables to establish the place of the regional political regimes in the space between authoritarianism and "almost democracy":

State control over mass media (MEDIA). This factor is quantified as the weighted average of the state share in the television (weight of 40 percent), radio broadcast (weight of 30 percent), and printing media production (weight of 30 percent) in a region;¹⁵

Electoral mandate of the acting head executive (EL_MAND). This variable is defined as the percent of votes the elected head executive received in the first round of the previous elections.¹⁶ The share of these employed by private enterprises in respect to the total number of those employed in the regional economy (PRIVAT). This variable is used as the proxy for economic liberalization. This may not be the best proxy for economic liberalization from a theoretical point of view, but it is one of the best available in the Goskomstat data for the period under study. The one-year lag between privatization and its effect on a regional economy is assumed.¹⁷

Controls—"Initial Conditions"

Ratio of GRP per capita in 1998 to the national average (GRP98). This variable is controlled as a proxy for the initial state of the development of a region. The control is especially relevant, since FDI inflows are measured as their volume per capita instead of the more conventional operationalization as the ratio to GRP or GDP. However, this study does not take a position in the well-known convergence debate;

Education 2000 survey data (EDU00). The positive effect of educational attainment on economic performance constantly finds strong empirical support in research on post-communist transformation (Fidrmuc 2000, on growth in CEE and the CIS; Broadman and Recanatini 1999; and Manaenkov 2000, on the FDI allocation among the Russian regions). This variable is measured as the share of persons with at least some professional or full secondary education among the economically active population of a region in 2000. The data are available only for that year, but the relative stability of this indicator over time can be safely assumed;

Natural resources (NATRES). The effect of natural resource endowment on relative performance of Russian regions can be ambivalent. On the one side, high

prices on crude oil, gas, and other natural resources on the world market are considered to be a factor that has boosted the post-1998 Russian recovery (Åslund, 2001). On the other hand, there is a possible association between natural resources and the ability of early transformation winners to resist subsequent reforms. According to the World Bank, "if the rents are large as a fraction of total gross domestic product, which is usually the case in natural resource- and energy-rich countries, these early winners may capture the state and force the economy into a trap of a low-level reform equilibrium" (2002, 10).¹⁸ Hydrocarbonates (oil and natural gas) remain the most attractive of Russia's natural resources. The variables on the production of oil and natural gas per capita in 1999, the last year for which the data are available, are highly correlated ($R = .98$, at the .001 probability level). To avoid redundancy, scores of their factor are employed as the control;

Distance from Moscow (LN_MSKD). In addition to being a proxy for the physical distance to federal government (that is, the distance that can increase the relative autonomy of a region, but diminish the ability of its elite to influence the policies and fund allocation by the central government), this variable can also substitute for the conventional control for the distance from a European capital.¹⁹ For example, the physical distances from Moscow correlate with those from Frankfurt with R equal to .99 and significant at the .001 probability level;

Climate (LN_CLIMA). There is no need to comment on the possible importance of this variable in the Russian circumstances. The variable is operationalized as the average temperature in January.²⁰

The logarithmic transformation of the form " $y = \ln(1+y)$ " is applied to the variables initially measured in absolute values (LN_FDI, LN_SME, LN_MSKD, LN_CLIMA). Table 1 presents descriptive statistics on the employed variables. Cases whose value on a variable differs from the mean by more than three standard deviations will be considered as outliers on those variables.

Method

In terms of method, this paper draws on the standard empirical studies of economic growth and investment rate determinants (Barro 1991; Levine and Renelt 1992). The employed approach recently has become a conventional one in empirical institutional economics.

Effects of explanatory factors are studied in three groups of linear regression models. Three explanatory variables of interest are entered in models of the first type. Because the hypothesis of "Putin's project" is that a "strong hand" can allow the positive effects of liberal economic policies to develop, the significance of the interactive term (PUT) of the state control over mass media (100-MEDIA), the electoral mandate for the regional head executive (EL_MAND), and economic liberalization (PRIVAT) is tested in the second type of models. To control for possible non-linear effects, models for the second-order functions of political regime variables are estimated next. Thus, the square transformations of MEDIA,

TABLE 1. Descriptive Statistics

Variable	N	Min.	Max.	Mean	Std. Dev.	Detected outliers ("")	
						3 Std. Dev. < Mean	3 Std. Dev. > Mean
GROW_ADJ	78	85.9	156.6	121.1	12.7	—	—
LN_FDI	234	.00	7.43	1.68	1.52	—	Sakhalin (1999, 2001)
LN_SME	156	.61	3.20	1.66	.40	—	St. Petersburg, Moscow City
MEDIA	234	3.0	72.0	25.6	13.5	—	Moscow City
EL_MAND	234	15.0	99.4	54.7	20.6	—	—
PRIV_LAG	234	21.7	63.3	43.3	8.0	—	—
GRP98	234	20.7	381.7	84.8	52.6	—	Tyumen, Moscow City
EDU00	234	70.1	97.5	87.9	3.8	—	—
LN_MSKD	234	.00	8.97	6.83	1.51	Moscow City, Moscow Reg.	—
NATRES	234	-1.7	8.63	.00	1.00	—	Tyumen
LN_CLIMA	234	-.69	3.76	2.54	.64	Krasnodar	—

EL_MAND, and PRIV_LAG (MEDIA_SQ, MAND_SQ, and PRIV_SQ, respectively) replace the interactive term in the third type of regression models.²¹ Controls apply:

$$Y_{ij} = \alpha_1 \cdot \text{MEDIA}_{ij} + \alpha_2 \cdot \text{EL_MAND}_{ij} + \alpha_3 \cdot \text{PRIV_LAG}_{ij} + \beta_1 \cdot \text{GRP_98}_i + \beta_2 \cdot \text{EDUSEC}_i + \beta_3 \cdot \text{NATRES}_i + \beta_6 \cdot \text{LN_MSKD}_i + \beta_7 \cdot \text{LN_CLIMA}_i + \varepsilon_{ij};$$

$$Y_{ij} = \alpha_1 \cdot \text{MEDIA}_{ij} + \alpha_2 \cdot \text{EL_MAND}_{ij} + \alpha_3 \cdot \text{PRIV_LAG}_{ij} + \alpha_4 \cdot \text{PUT}_{ij} + \beta_1 \cdot \text{GRP_98}_i + \beta_2 \cdot \text{EDUSEC}_i + \beta_3 \cdot \text{NATRES}_i + \beta_6 \cdot \text{LN_MSKD}_i + \beta_7 \cdot \text{LN_CLIMA}_i + \varepsilon_{ij};$$

$$Y_{ij} = \alpha_1 \cdot \text{MEDIA}_{ij} + \alpha_2 \cdot \text{MEDIA_SQ}_{ij} + \alpha_3 \cdot \text{EL_MAND}_{ij} + \alpha_4 \cdot \text{MAND_SQ}_{ij} + \alpha_5 \cdot \text{PRIV_LAG}_{ij} + \alpha_6 \cdot \text{PRIV_SQ}_{ij} + \beta_1 \cdot \text{GRP_98}_i + \beta_2 \cdot \text{EDUSEC}_i + \beta_3 \cdot \text{NATRES}_i + \beta_6 \cdot \text{LN_MSKD}_i + \beta_7 \cdot \text{LN_CLIMA}_i + \varepsilon_{ij};$$

where Y is a response variable (GROW_ADJ, LN_FDI, or LN_SME).

All three specifications are estimated for each of the three response variables for the full pool of seventy-eight regions, i.e. 78, 234, and 156 observations for GROW_ADJ, LN_FDI, or LN_SME, respectively. So that the estimates are not driven by a small number of outliers, the same nine specifications are estimated for restricted samples, which exclude outliers on the response variable or at least two of the predictors.

Empirical Analysis

Effects of Policy Factors on Economic Growth

The estimated models for the GRP change in 1999 are reported in table 2. Neither the explanatory variables of interest, nor their interactive term, nor their square transformations exhibited a significant partial correlation with the proxy for economic growth in any specification. There are three possible explanations for this result. First, GRP/GDP measurement may be an unreliable indicator of economic performance in transition. The reasons are stated above. Second, 1999 was the year immediately after the deep economic crisis of 1998, when economic factors could have been considerably disoriented. Third, the effects of policies on total economic output may need more time to develop, or, perhaps, cannot be captured in the data aggregated for a mere one-year period.

Effects of Policy Factors on Regional FDI Inflows

Table 3 presents the estimation of models for regional FDI inflows. The restricted sample excludes Sakhalin (which has hosted a large FDI project in the natural gas production), Moscow City, St. Petersburg, and the region of Tyumen.

The estimates demonstrate a significant positive effect of the share of the independent mass media in a regional media market (MEDIA) on FDI inflows. The estimated elasticities are 1.6 and 1.9 for the full and restricted samples, respectively. This means that an increase in the share of the independent mass media by 1 percent corresponds with an additional 1.6–1.9 percent of FDI inflows in the region. Figure 2 illustrates the relationship between the independence of the mass media and FDI inflows.

TABLE 2. Linear Regression Models for GROW_ADJ

Model Type	Full Sample			Restricted Sample (excluding Moscow City, Tyumen)		
	1	2	3	1	2	3
(Constant)	138.21 (3.35)	6.09 (.13)	-3.32 (-.05)	142.15 (3.52)	11.73 (.23)	-3.80 (-.06)
MEDIA	.17 (1.40)	.20 (1.06)	.168 (.60)	.205 (1.75)	.199 (.99)	-.013 (-.04)
MEDIA_SQ	—	—	-.002 (-.39)	—	—	.002 (.35)
EL_MAND	-.04 (-.53)	-.23 (-.96)	-.180 (-.51)	-.023 (-.32)	-.161 (-.59)	-.188 (-.53)
MAND_SQ	—	—	.001 (.40)	—	—	.001 (.47)
PRIV_LAG	-.37 (-1.71)	-.61 (-1.66)	.005 (.00)	-.285 (-1.31)	-.481 (-1.20)	.266 (.14)
PRIV_SQ	—	—	-.004 (-.18)	—	-.007 (-.18)	— (-.29)

	6.6E-05 (.81)	—	4.5E-05 (.49)	—
PUT	—	—	—	—
Controls				
GRP98	<i>.10</i> (2.22)	15.39 (3.72)	14.19 (3.44)	15.34 (3.53)
EDU00	<i>-.08</i> (-.19)	<i>-.40</i> (-.94)	<i>-.311</i> (-.77)	<i>-.392</i> (-.93)
LN_MSK	<i>1.09</i> (1.08)	<i>.76</i> (.77)	<i>.375</i> (.35)	<i>.193</i> (.17)
NATRES	<i>-2.76</i> (-1.34)	<i>-2.16</i> (-1.40)	<i>10.34</i> (1.04)	<i>10.65</i> (1.04)
LN_CLIMA	<i>-5.09</i> (-2.03)	<i>-6.48</i> (-2.51)	<i>-5.83</i> (-2.34)	<i>-5.94</i> (-2.29)
R Square	<i>.195</i>	<i>.294</i>	<i>.316</i>	<i>.319</i>
Adj. R Square	<i>.102</i>	<i>.176</i>	<i>.222</i>	<i>.202</i>
Std. Error of the estimate	12.00	11.49	11.285	11.43
F	2.09	2.50	3.39	2.73
Significance	.048	.011	.002	.006

Note: The upper part of the table reports unstandardized β -coefficients with *t*-ratios in parentheses. The coefficients significant at the .01 probability level are in bold; other coefficients significant at the .05 probability level are in italics.

TABLE 3. Linear Regression Models for LN_FDL

Model Type	Full Sample			Restricted Sample (excluding Moscow City, Tyumen)		
	1	2	3	1	2	3
(Constant)	-5.38 (-2.16)	-5.38 (-2.17)	-6.58 (-2.019)	-5.16 (2.10)	-5.13 (-2.09)	-6.49 (-1.99)
MEDIA	.016 (2.24)	.031 (2.89)	5.0E-02 (2.876)	.019 (2.71)	.032 (2.91)	3.3E-02 (1.51)
MEDIA_SQ	—	—	-6.2E-04 (-2.224)	—	—	-2.8E-04 (-.74)
EL_MAND	-.005 (-1.26)	-.032 (-2.15)	-1.4E-02 (-.686)	-.004 (-.89)	-.027 (-1.71)	-1.3E-02 (-.62)
MAND_SQ	—	—	7.7E-05 (.431)	—	—	7.8E-05 (.43)
PRIV_LAG	.016 (1.32)	-.014 (-.71)	7.4E-02 (.787)	.024 (1.94)	-.002 (-.11)	9.9E-02 (1.05)
PRIV_SQ	—	—	-6.5E-04 (-.601)	—	—	-8.8E-04 (-.80)

	8.5E-06 (1.87)	—	8.5E-06 (1.87)	—	7.3E-06 (1.53)	—
PUT	—	—	—	—	—	—
Controls						
GRP98	.014 (5.27)	.016 (5.665)	.016 (5.51)	.016 (5.48)	.016 (5.48)	.017 (5.42)
EDU00	.081 (3.24)	.080 (3.118)	.078 (3.18)	.078 (3.18)	.086 (3.43)	.076 (2.98)
LN_MSK	-.066 (-1.11)	-.081 (-1.362)	-.147 (-2.19)	-.147 (-2.19)	-.153 (-2.28)	-.133 (-1.90)
NATRES	-.167 (-1.38)	-.219 (-1.774)	1.246 (2.04)	1.246 (2.04)	1.308 (2.15)	1.239 (2.03)
LN_CLIMA	-.619 (-4.10)	-.661 (-4.295)	-.603 (-4.04)	-.603 (-4.04)	-.550 (-3.60)	-.620 (-4.03)
R Square	.369	.384	.351	.351	.358	.354
Adj. R Square	.347	.353	.328	.328	.331	.321
Std. Error of the estimate	1.23	1.22	1.21	1.21	1.21	1.21
F	16.45	15.18	14.82	14.82	13.48	10.78
Significance	.000	.000	.000	.000	.000	.000

Note: The upper part of the table reports unstandardized β -coefficients with t -ratios in parentheses. The coefficients significant at the .01 probability level are in bold; other coefficients significant at the .05 probability level are in italics.

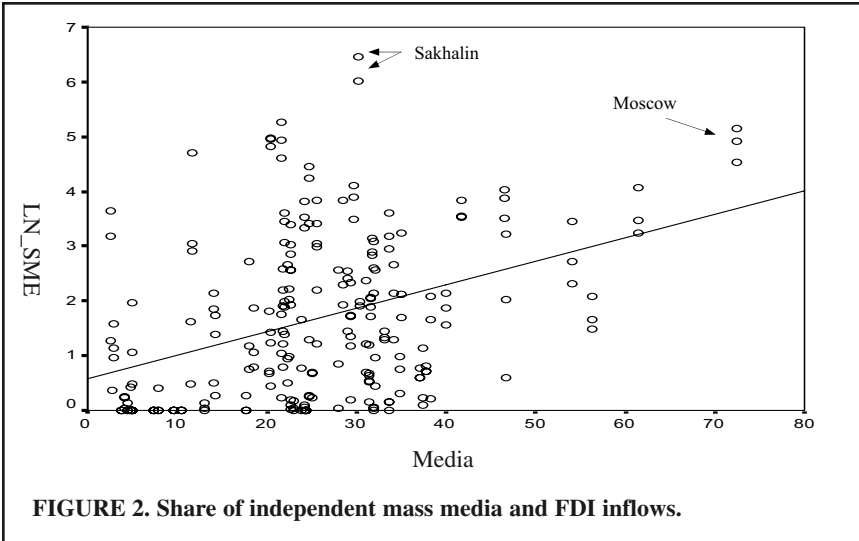


FIGURE 2. Share of independent mass media and FDI inflows.

The model for the full sample indicates that the effect may turn negative after a certain threshold. However, as the estimation for the restricted sample confirms, this non-linearity has appeared solely because Moscow City, a positive outlier on the strength of the independent mass media and GRP per capita, attracted considerably less FDI in 1999–2001 than one may expect, given the high potential of the region.

The effect of the interactive term does not appear significant; but, when it enters the model, the strength of electoral mandate for the regional head executive turns significantly negative. A possible explanation is that the effect of governor's electoral mandate may be marginally negative, when the popular support is not accompanied by the control over mass media and economic liberalization. Advances in privatization appear to be weakly associated with larger FDI inflows (t -ratio of 1.94, significant at the .1 probability level in the model, estimated on the restricted sample).

These findings hardly can be interpreted as empirical support for the hypothesis of "Putin's project." Moreover, we see that freedom of press is associated with higher FDI inflows. The relationship between the effects of political and economic liberalization on FDI inflows becomes apparent, when the model with MEDIA, PRIV_LAG, and controls is estimated on a restricted sample split on the strength of the governor's electoral mandate in two parts with 50 percent as the cutting point (table 4). The level of privatization appears to be a crucial factor for FDI attraction in the regions where elections have been highly competitive. In the rest of the country (forty-three regions), political liberalization seems to generate incentives for regional policy-makers to make the business environment more auspicious for foreign investors.

TABLE 4. Linear Regression Models for LN_FDI (Regions Classified in respect to strength of electoral mandate of regional chief executive)

	Votes received by the acting regional chief executive in the first ballot			
		< 50%		> 50%
(Constant)	-16.5	(-2.94)	-4.8	(-1.89)
MEDIA	.02	(1.71)	.02	(2.41)
PRIV_LAG	.06	(2.43)	.01	(.63)
Controls				
GRP98	<i>1.20</i>	(2.08)	1.46	(5.17)
EDU00	.17	(3.01)	.07	(2.70)
LN_MSK	<i>-.20</i>	(-2.04)	.06	(.82)
NATRES	<i>-.08</i>	(-.36)	<i>-.21</i>	(-1.33)
LN_CLIMA	<i>.33</i>	(.89)	-.88	(-5.82)
R Square		.311		.504
Adj. R Square		.258		.476
Std. Error of the estimate		1.40		1.04
F		5.93		18.28
Significance		.000		.000

Note: Estimations are based on the restricted sample (excl. Moscow City, Sakhalin, Tyumen). The upper part of the table reports unstandardized β -coefficients, and t -ratios in parentheses. The coefficients significant at the .01 probability level are in bold; other coefficients significant at the .05 probability level are in italics.

Effects of Policy Factors on SME

Which factors influence the environment for small entrepreneurs? Table 5 presents the estimations based on the full and restricted samples. The latter sample does not include Moscow City or St. Petersburg, two regions with the highest number of small enterprises per capita and most liberalized mass media, and Tyumen, which is distinguished by vast natural resources and high GRP per capita.

The share of independent mass media appears to be strongly associated with the development of small entrepreneurship. In fact, it is the strongest predictor in both estimations of the first-type model. According to these estimates, an increase in the share of independent mass media by 1 percent corresponds with an additional 1.2 percent in the regional stock of small enterprises. The association is illustrated by figure 3.

TABLE 5. Linear Regression Models for LN_SME

Model Type	Full Sample			Restricted Sample (excluding Moscow City, Tyumen)		
	1	2	3	1	2	3
(Constant)	-823 (-1.14)	-85 (-1.18)	-2.155 (-2.30)	-766 (-1.06)	-.79 (-1.09)	-2.16 (-2.28)
MEDIA	.012 (5.67)	8.7E-03 (2.58)	-7.5E-03 (-1.58)	.012 (5.39)	.010 (2.81)	-1.2E-02 (-1.99)
MEDIA_SQ	—	—	3.2E-04 (4.16)	—	—	4.1E-04 (3.86)
EL_MAND	-.003 (-2.52)	2.4E-03 (.54)	-8.0E-04 (-.14)	-.003 (-2.80)	-5.3E-04 (-.11)	3.5E-04 (.06)
MAND_SQ	—	—	-1.9E-05 (-.38)	—	—	-2.6E-05 (-.51)
PRIV_LAG	-.001 (-.36)	5.1E-03 (.80)	7.6E-02 (2.46)	-.002 (-.49)	1.5E-03 (.23)	7.8E-02 (2.45)
PRIV_SQ	—	—	-9.5E-04 (-2.55)	—	—	-9.5E-04 (-2.52)

PUT	—	-1.8E-06 (-1.27)	—	-9.7E-07 (-.62)	—
Controls					
GRP98	.484 (3.30)	.465 (3.16)	.472 (3.35)	.380 (2.37)	.523 (3.41)
EDU00	.026 (3.52)	.024 (3.27)	.025 (3.56)	.024 (3.26)	.025 (3.58)
LN_MSK	.000 (-.03)	.004 (.22)	.008 (.51)	.019 (.94)	-.004 (-.22)
NATRES	-.076 (-2.53)	-.072 (-2.40)	-.071 (-2.56)	-.055 (-.29)	-.017 (-.10)
LN_CLIMA	-.057 (-1.30)	-.069 (-1.55)	-.060 (-1.44)	-.065 (-1.44)	-.053 (-1.25)
R Square	.486	.492	.569	.405	.492
Adj. R Square	.458	.461	.536	.368	.452
Std. Error of the estimate	.30	.30	.28	.30	.28
F	17.40	15.71	17.28	10.76	12.34
Significance	.000	.000	.000	.000	.000

Note: The upper part of the table reports unstandardized β -coefficients with t -ratios in parentheses. The coefficients significant at the .01 probability level are in bold; other coefficients significant at the .05 probability level are in italics.

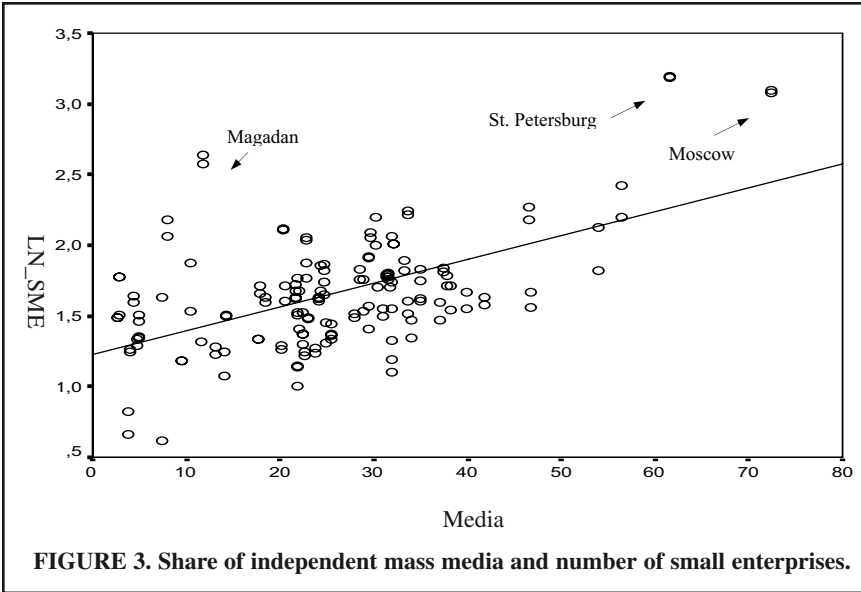


FIGURE 3. Share of independent mass media and number of small enterprises.

Another policy factor, which is significant in these two estimations, is the strength of the governor's electoral mandate, but, in spite of the beliefs in the beneficial "strong hand," the partial correlation between this factor and the development of small businesses is negative. Thus, both employed indicators of political liberalization—the independence of mass media and competitiveness of elections—are highly significant predictors for the number of small enterprises.

The interactive term of policy variables does not prove to be significant. However, a non-linearity in the effect of the mass-media independence on the development of small businesses is observed. The share of the independent mass media has a J-shaped effect on the environment for small entrepreneurship; the latter becomes worse on very cautious initial advances on the scale of political liberalization, but improves rapidly when a certain threshold is overcome. This threshold can be estimated between 24 percent and 30 percent (on the full and restricted samples, respectively).

Conclusion

This study has not found any empirical support for the hypothesis that government by a "strong hand" in combination with liberal economic policy has had a positive impact on economic performance of Russian regions in 1999–2001. On the contrary, more politically liberalized regions tended to receive larger FDI inflows and accommodate more small enterprises. This finding casts serious doubt on the feasibility of "Putin's project," if the latter will not incorporate an effort to democratize the country.

Political liberalization seems to have a J-shaped impact on the development of small entrepreneurship. The indicators of economic performance decline on

the very low levels of political liberalization but improve when a certain threshold is passed. This finding corresponds to the results of recent comparative studies of post-communist transformation (Fidrmuc 2000). On the one hand, the non-linearity of the relationship may explain why the recent reversal in terms of political freedoms seems to have a beneficial (or at least neutral) effect on the economic situation in Russia. On the other hand, it indicates that democratic reforms are necessary to make high economic performance sustainable in a longer-term perspective.

Generally, the present analysis supports the notion of Russia as a "normal country," for which a "special way" around liberal democracy and open market may be an impasse. Further, this paper contributes to the ongoing debates on the relative importance of reforms in comparison with initial conditions (such as initial level of development, natural resource endowment, and geographical location). The argument is that policies *do* matter.

Further, the above findings may shed light on the causes of the Russian economic contraction in the 1990s. Probably, the economic crisis was due to the lack of democratic control and not to political or economic liberalization. However, this paper does not incorporate rigorous causality tests. Thus, testing and exploration of the supposed link between political liberalization and economic development remains a challenge and a subject for further investigation.

NOTES

1. A more skeptical vision is that the devaluation merely inflated accounting figures for GDP. According to Gaddy and Ickes (2000), the ruble devaluation of 1998 decreased the relative share of the "virtual" (subsidized or "value-destroying") part of the Russian economy in nominal terms. Thus, the following upsurge can be partially explained by the fact that new relative prices give more weight to more productive (exporting) sectors in accounting for the performance of the economy as a whole.

2. Generally, policies by the pre-Putin governments in late 1998 and 1999, (prime-ministers Primakov and Stepashin) were quite similar: strengthening the state plus some more cautious, liberal reforms in the economy.

3. The new authority has not been used so far, but observers suspected that the governor of the Maritime Province had to resign under threat of the implementation of this law.

4. This share was over 60 percent in 1997; it dropped to 49 percent in 2001, and was expected to decline to 45.2 percent in 2002. The figures come from the Internet edition of the *Russia Monitor*, 2001-38, available on-line at <http://www.russiamonitor.org/>.

5. For a detailed review of Putin's federal reforms, see Orttung (2002). Particularly interesting is his reference to the December 2001 monthly survey of Russian political elite by *Nezavisimaya gazeta*, which indicated that most regional leaders either lost their place or stepped back in its list of the top one hundred most influential politicians.

6. Interestingly, Putin's "war on oligarchs" finds some justification in the policy framework advocated by the World Bank (2002), which argues: "Governments must also be able to constrain oligarchs and insiders from using their initial advantages in the reform process to derail further reforms that would create a more competitive market economy" (28).

7. According to the estimates by de Melo et al. (1996) and the EBRD (2000), Russia was one of three post-communist countries that experienced some regress in economic liberalization between 1995 and 1998. The other two were Belarus and Uzbekistan.

8. Because of public preferences for a strong state, the president and government officials

refrain from using the more conventional term “deregulation.”

9. Selowsky and Martin (1998) report that economic liberalization had a quick and positive impact in CEE, while its effect in the CIS was initially deteriorative, and became positive only after several years of transformation.

10. Remarkably, the authors also reveal a negative impact of the participation in the IMF programs.

11. Chukotka is not a part of another region; however, other reasons not to treat the ten autonomous districts of the Russian Federation as independent analytical units apply to its case as well. These are: (1) data problems and (2) doubtful comparability of entities with almost nine million and about twenty thousand of the population of Moscow City and Evenkian autonomous district, respectively.

12. The more conventional normalization of FDI inflows as ratio to GRP is not employed because of the lack of the data on the latter.

13. The data on the response variables come from Goskomstat (2001b).

14. Another explanation is that the Goskomstat data on economic growth overestimate changes in output of large industrial enterprises and underestimate the development of small entrepreneurship and the service sector.

15. The source of the data is a report by a non-governmental initiative “Public Expertise” (available online at <http://www.freepress.ru/>). For the sixty-six cases on which the information about the share of the independent press has been available in full, Pearson correlation between the index and the factor score of the first principal component of the three indicators is .951, which is significant at .001 probability level. Missing cases have been assigned the average value for other regions in the respective federal district. In cases of the Southern and Siberian regions, some data were missing for republics and, because of the large differences in the average values between autonomous or non-autonomous regions in these districts, the assigned values are the averages for the autonomies in the respective district.

16. This variable can be endogenous with economic performance; we should keep this possibility in mind.

17. The hypothesis of a contemporaneous effect of liberalization on performance is rejected by Selowsky and Martin (1998). The World Bank (2002) suggests the time lag of three years. However, most empirical research has produced valuable results assuming a shorter response time.

18. Besides that, the over-profits in the natural resource sector may be an obstacle for the rest of the economy. According to Putin’s economic advisor A. Illarionov, the natural resource sector distracts crucial inputs (investment, well-trained workforce, etc.) from other sectors, including those of them that, like manufacturing, may generate more positive externalities in terms of socio-economic development (the so-called “Dutch disease” model).

19. The latter proxy is usually included to control proximity to Western European markets and the European cultural influence (Fidrmuc 2000; Fischer et al. 1998; Manaenkov 2000; Murrel 1996).

20. The data on the first three controlled factors come from Goskomstat (2001a, 2002a). The data on the physical geographical variables are shared by S. Samokhina, Saratov University.

21. I would simultaneously enter the interactive term and square transformations, if the former and some of the latter had been significant in the specifications of the type 2 and 3 for the same response variable, but this was not the case.

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