

Economic and Social Policy Trade-Offs in the Russian Regions: Evidence from Four Case Studies

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Abstract

Through case studies of four Russian regions, we examine the trade-offs between social and economic policy at the regional level. All four regions studied seek to stimulate entrepreneurship while preserving or expanding social welfare coverage. Regions differ in development strategies, some placing greater emphasis on indigenous business development and others seeking to attract outside investment. Variation in levels of democracy are unrelated to policy choices. All four regional governments consult actively with local business associations while organised labour is weak. The absence of effective institutions to enforce commitments undermines regional capacity to make social policy an instrument for long-term development.

THE REGIME TRANSITION FROM COMMUNISM TO CAPITALISM IN Russia and elsewhere challenges policy makers to devise new structures for social provision 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 (Gel'man *et al.*, 2003; Cook, 2007; Haggard & Kaufman 2008; Zubarevich 2009; Frye 2010). In Russia, regional governors confront 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 maintaining the social benefits expected by the population.

In this article, we examine the strategies adopted by regional governments in Russia in the face of this redistributive dilemma. Specifically, how do governors balance their social and economic policies? For example, how do they reconcile their obligations in the spheres of

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education, health care, unemployment benefits, housing and utilities rates, poverty relief, and support for vulnerable and dependent strata, with their desire to stimulate economic development? Do governors have a long-term strategy for regional development using measures of social policy to contribute to long-term growth? Finally, what leads governors to give priority to one set of social and economic policies over another?

Like the central government, governors in Russia must also 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 infrastructure impose heavy demands on the budget. 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 while at the same time ensuring a steady flow of budget revenue to the centre. Thus governors confront a number of pressing short-run demands that can pre-empt a long-term development strategy.

An extensive literature exists detailing economic, social and other policy demands on regional governments in Russia (Hanson & Bradshaw 2000; Ross 2002a, 2002b; Hanson 2003; Petrov & Titkov 2010; Sharafutdinova 2010; Remington 2011). Comparatively few, however, address the way regional decision makers themselves view the trade-offs these challenges impose and the way they resolve them. In this article, we use case studies of four Russian regions to understand the strategies that ruling elites pursue as they manage the competing objectives of economic development and social protection. Our findings suggest that regional governments regard social and economic policy measures as being in tension rather than as reconcilable elements of a long-term plan for regional development.

Research design

Budget constraints limited our study to four regions. We chose four that were reasonably representative of Russian regions generally but that also varied in economic, social and political characteristics. Our selection was based on four sets of criteria: level of urbanisation (we excluded the least urbanised regions); size of population (we excluded the least populous regions); level of social and economic development; and level of political pluralism. We also chose not to examine ethnic territories due to their specific institutional characteristics. For the first three criteria we relied on Russian state statistical data, and for the last we used the ratings of democracy developed by the Moscow Carnegie Center.¹ Our method was to select relatively representative regions with respect to urbanisation, population size and level of development, and within those to select regions with relatively favourable social-economic conditions. Ultimately we settled on Perm' and Krasnoyarsk, which are relatively industrialised and prosperous, and have higher than average ratings for level of democracy; Voronezh, a moderately industrialised region with a large and relatively successful agricultural economy, and with a democracy score slightly above average; and

¹The ratings of the level of democracy 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, accessed 24 September 2010.

Kirov, a less industrialised region with a democracy score nearly equal to the Russia-wide median. Our method was primarily qualitative. Our team conducted 12–20 in-depth interviews in each region, with each interview usually lasting for one or two hours.² Our respondents were selected in roughly equal proportions from among regional governments and legislatures; experts from academia and the media; and business associations. All were promised anonymity and are identified only by generic affiliation.

The institutional setting

Before examining regional strategies in more detail, we consider the institutional environment in which governors operate, focusing on three dimensions in particular: the political relationship between regional authorities and the federal centre; fiscal constraints; and the set of channels of communication and decision making connecting the regional government with organised interests, particularly business and labour.

Central–regional relations

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. The centre holds them responsible for their political and economic performance. A recurrent theme is that popular 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 centre sets two principal tasks for governors: to ensure social stability in the region; and to ensure good results for United Russia in federal and regional elections. 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. 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 centre 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 (Reuter 2011). Similarly, a study by Natalia Zubarevich of the social and investment priorities of the federal authorities in 2009–2010 found that the centre 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 there had been open manifestations of popular discontent (as in Vladivostok) (Zubarevich 2011). Good results for United Russia improve a governor's standing with the federal authorities and his

²Interviews in Perm' *krai* and Kirov *oblast'* were conducted from 5 to 12 July 2010. Interviews in Krasnoyarsk were conducted from 23 to 29 August 2010, and those in Voronezh were conducted from 27 September to 1 October 2010. Respondents are identified by letter and number. KI refers to Kirov; KR refers to Krasnoyarsk; V refers to Voronezh; P refers to Perm'. Respondents were assured that they would be identified only by generic institutional affiliation.

ability to enact his legislative programme in the regional assembly. Of course, governors are also expected to follow the centre's lead in social and economic policy. As one expert from Krasnoyarsk put it, 'the *krai* works the way the government dictates from above'.³

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 means 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 subsidised 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 (Remington 2011). 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 (Chirikova 2010, p. 118).

Since governors mediate between Moscow's demands and pressures from local elites, a governor's strategy depends in part on whether he is an 'insider' with established ties to the local political and business elite, or an 'outsider' appointed from Moscow or another region.⁴ Among our four regions, two have outsider governors and two insiders. Interviews reveal that a crucial aspect of this distinction is the composition of the governor's 'team'—the set of associates appointed by the governor to key advisory and decision-making roles in his administration.

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*. 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. Belykh's difficulty is compounded by his strongly pro-market orientation. Some members of the local elite are sceptical 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. 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 is not happening'.⁵

The governor of Voronezh *oblast'*, Alexei Gordeev, was also appointed from outside. Previously he had been federal minister of agriculture and vice-premier in 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:

³Interview with KR12, head of a local NGO, Krasnoyarsk, August 2010.

⁴Generally, in recent years, there have been more outsider governors (Petrov & Titkov 2010).

⁵Interview with KI8, leading member of a local business association, Kirov, July 2010.

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.⁶

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 skilfully built up his own personal authority. Generally, respondents from the business and expert communities have 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 programme 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.⁷

The fiscal environment

All regional governments face fiscal constraints, but poor regions have 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 regions, such as Kirov *oblast'*, federal transfers comprise well over half of the regional budget.⁸ 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 the region in order to attract investment and in fact use

⁶Interview with V14, professor at a local university, Voronezh, September 2010.

⁷On 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 centralisation of federal power associated with Vladimir Putin, the regional heads of these bodies have been replaced by outsiders who are presumably loyal to Moscow rather than to the local political establishment (Petrov & Titkov 2010). Also see Nikolai Petrov's comments at the Carnegie Center, Moscow on 13 October 2010, available at: <http://www.carnegie.ru/events/?fa=3080>, accessed 25 June 2011.

⁸Some 60%, according to Governor Belykh (Belykh 2011).

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.⁹ 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 (Belykh 2011). 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. 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 on. The social payments that exist in this sphere are the biggest quantity of resources. Unfortunately, this does not include education, cultural employees, health care. But these are the social obligations of the state and it must fulfil them. You can't get away from them.¹⁰

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 monetise 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'.¹¹

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. Again Kirov *oblast'* suggests the magnitude of the problem. According to Governor Belykh, the region has 2,000 settlements with fewer than ten inhabitants and 8,000 with fewer than 50. There are rural schools with fewer than four pupils (Belykh 2011). 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 provoke active 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. A Voronezh entrepreneur told us:

⁹As of 2000, half or more of the population received one or another social benefit from the state. The Ministry of Labour estimated that the number was closer to two thirds of the population, but 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 non-monetary benefits system on a cash footing and providing income supplements to the population to purchase them (see Remington 2011, pp. 47–48, 64–65).

¹⁰Interview with KI4, government official, Kirov, July 2010.

¹¹Interview with P3, regional government official in a social services department, Perm', July 2010.

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.¹²

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.¹³ 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 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.¹⁴

In view of the fact that the public sector ('budget sector' employees) comprises as much as a quarter of all employment in Russia,¹⁵ 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 organised sectors of society. We can divide these into two types, parliamentary and corporatist. The parliamentary institutions include regional legislative elections, parties and legislative assemblies. The corporatist institutions include the tripartite bodies for bargaining and consultation over economic and social policy among business, labour and government. Both sets of institutions work more in the breach than in fact, but, to be sure, neither is entirely irrelevant. As respondents reminded us, electoral 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 that dominates them, offers businesspeople valuable opportunities for lobbying. Therefore, in all four regions businesspeople are well represented among the deputies to the regional legislature. In Voronezh, deputies from

¹²Interview with V10, chairman of a local business association, Voronezh, September 2010.

¹³For 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 \$9,000 per year. And in addition to base salary, state officials are entitled to a wide array of cash bonuses and in-kind benefits, making actual income considerably higher ('Zarplaty regional'nykh chinovnikov v 1.5 i bolee raz prevyshayut dokhody srednestatisticheskogo grazhdanina', *Vedomosti*, 29 March 2011).

¹⁴Interview with KR10, head of the Department of Entrepreneurship in the administration of Krasnoyarsk krai, Krasnoyarsk, August 2010.

¹⁵Budget 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*, 20 August 2009, available at: <http://www.polit.ru>, accessed 20 August 2009).

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 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, effektivnye 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 is spent on all sorts of things to promote the Perm' brand.¹⁶

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 two 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 3,000 people, but not building anything here [in the main city].¹⁷

Respondents uniformly treated the tripartite commissions that develop collective bargaining agreements over wage and other conditions as purely *pro forma*. This is for several reasons. Business, as our respondents indicated, faces difficulty in overcoming its own collective dilemmas: small, medium and large businesses differ in their needs, interests and level of autonomy; firms compete for particularistic favours from government; and business associations themselves compete for members and government attention. Moreover, labour's organisational power is even weaker than business's. The close ties between workers and their place of work for social benefits has continued to inhibit collective action by labour 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 (Connor 1996; Clarke 1999, 2007; Ashwin & Clarke 2003; Remington 2011). Issues 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 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

¹⁶Interview with P12, professor at Perm' State University, Perm, July 2010.

¹⁷Interview with V8, head of a working group in regional government responsible for social-economic development, Voronezh, September 2010.

authorities are directed at gathering them and organising with them some sort of dialogue. But this is occurring with great difficulty—with great difficulty’.¹⁸

Probably the region with the most active consultation between business and government is Kirov *oblast’*, where Governor Belykh makes a point of discussing regional policy with business associations and where business associations are most fully developed. Both representatives of the business associations and of government agree that there is active consultation. This participation is institutionalised to some extent in that the heads of the Vyatsk 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.¹⁹ 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’.²⁰

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. Business representatives cited several instances where business was able to affect policy, such as 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. The head of a government-sponsored centre for entrepreneurship in Perm’ described the authorities’ relations with business as mutually beneficial: ‘Of course we exploit them [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’.²¹

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 organised 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 that even when the governor tried to conduct serious discussions with business, it was 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’.²²

¹⁸Interview with KR6, vice-chair of the regional legislature, Krasnoyarsk, August 2010.

¹⁹The same practice has been institutionalised at the federal level, where the Russian Union of Industrialists and Entrepreneurs (RUIE—Rossiiskii soyuz promyshlennikov i predprinimatelei) and the Federation of Independent Trade Unions of Russia (FNPR—Federatsiya nezavisimyykh profsoyuzov Rossii) were given the right to attend meetings of the government (*Polit.ru.*, 11 January 2011, available at: <http://www.polit.ru>, accessed 11 January 2011).

²⁰Interview with KI4, deputy chairman of government of Kirov *oblast’*, Kirov, July 2010.

²¹Interview with P13, head of a government-sponsored centre for entrepreneurship in Perm’, Perm, July 2010.

²²Interview with KR6, a deputy of the Krasnoyarsk legislative assembly, Krasnoyarsk, 23 August 2010.

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 organisers of the given roundtable, gave their report. But a roundtable where there was a real discussion, I have not had the pleasure of being at any such.²³

Government officials often expressed frustration that business tended to react to policy rather than to advance policy proposals of its own. A senior member of the regional administration in Kirov noted that 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.²⁴

For their part, business representatives commonly complained that their interests were not taken into account by government. A newspaper editor from Voronezh stated:

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 [at the level of officialdom] there are only paper reports [*odni relyatsii*], but in actuality everything is otherwise. That is, there is no linkage from below to up above.²⁵

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 façades.

In almost all cases, business representatives complained about the lack of access to information about regulations and policies. Asked to characterise the business climate in his region, one respondent said 'it's not a climate, it's a total fog!'²⁶ 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 organisational 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.

In general, it appears that 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

²³Interview with P1, official in the Perm' *oblast'* government centre for development of entrepreneurship, Perm', July 2010.

²⁴Interview with KI2, vice-chair of government of Kirov *oblast'*, Kirov, July 2010.

²⁵Interview with V12, newspaper editor, Voronezh, September 2010.

²⁶Interview with KR8, official with a regional business association, Krasnoyarsk, August 2010.

business services to either parliamentary or corporatist structures that would commit them to defined rules for decision making. *Ad hoc* consultations do not give organised 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 organised labour and political parties. In any case, governors’ leadership styles and policy objectives appear to be better explanations of the nature of government–business relations than variation in the democracy scores.

Governors’ policy goals

Governors pursue their own personal and policy goals within the institutional constraints outlined above. 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. Governors also differ in their ideological preferences. Some have a strongly liberal, pro-market, orientation—among our four regions, this characterises 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 infrastructure development 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 (Belykh 2011). Therefore governors often prefer to focus on projects with more immediate benefits.

We can gain some insight into 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.²⁷ 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. But even critics of Belykh agree that he is not pursuing private commercial interests or using his office to extract rents.

Yet regardless of the governor’s personal preferences, the situation in the region is such that the regional government must expend substantial resources on social protection. A senior government official told us:

²⁷Belykh alluded to this in his interview with *Polit.ru* when he noted that he had no plans to run for president in 2012, but that an advantage to being young—he was born in 1975—was that he was able to look 20 or 30 years ahead (Belykh 2011).

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 programmes 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 programmes of support for those who could, after a certain time, become the 'lower middle class'.²⁸

Another government official stated: 'the policy in the *oblast*' is more social than directed toward developing business. That is, in the first instance it means pensioners'.²⁹

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. 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.

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.³⁰

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 modernised, laid off workers need new jobs. A member of the regional legislature 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'.

²⁸Interview with P1, senior government official, Perm', July 2010.

²⁹Interview with KI5, deputy chairman of Kirov *oblast*' government, Kirov, July 2010.

³⁰Interview with KR10, head of the Department of Entrepreneurship in the administration of Krasnoyarsk *krai*, Krasnoyarsk, August 2010.

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 recognise 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.³¹

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,³² but he has personal business interests in the region as the owner of a chain of supermarkets. 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 university professor noted, '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'.³³ The chief goal, said respondents, is to build up small and medium business. According to a head of a business development centre,

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 favourable atmosphere for small business.³⁴

The region is also deliberately working to commercialise public services. A government official declared:

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.

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'.³⁵

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!'³⁶ The

³¹Interview with KR6, deputy chair of regional legislature, Krasnoyarsk, August 2010.

³²Trutnev became federal minister for natural resources.

³³Interview with P12, professor at Perm' State University, Perm', July 2010.

³⁴Interview with P13, director of a regional centre for development of entrepreneurship, Perm', July 2010.

³⁵Interview with P3, regional government official in a social services department, Perm', July 2010.

³⁶Interview with P3, regional government official in a social services department, Perm', July 2010.

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, people between 30 and 35 years of age 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 economic development or social protection depending on their preferences, resources and constraints. No governor in the regions we studied has adopted a radical strategy of shifting entirely back toward a 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, 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 labour. In effect, governors face strategic choices similar to those of the national-level post-communist states, where rulers can opt to ally with interests favouring market-oriented growth or with the sectors preferring to preserve traditional statist controls over the economy and a redistributive social policy (Frye 2010).

The dilemma of growth as opposed to 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 labour released from over-staffed state enterprises. Poorer regions such as Voronezh and Kirov, with older populations, a larger rural sector, and many non-profitable enterprises, 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 0.57 (sig = 0.0000), while the correlation between the share of the budget devoted to social protection and gross regional product is weakly negative ($r = -0.27$, sig = 0.016). 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 ($r = -0.68$, $\text{sig} = 0.0000$) and a weaker but still significant negative correlation between economic spending and spending on social protection alone ($r = -0.42$, $\text{sig} = 0.0001$). Figures 1–4 illustrate these 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 wellbeing 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.

Governments seek to resolve the trade-off between social support and economic development in various ways. In all four regions, governments look 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. 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.

The head of a project for developing entrepreneurship in the regional government in Perm' told us:

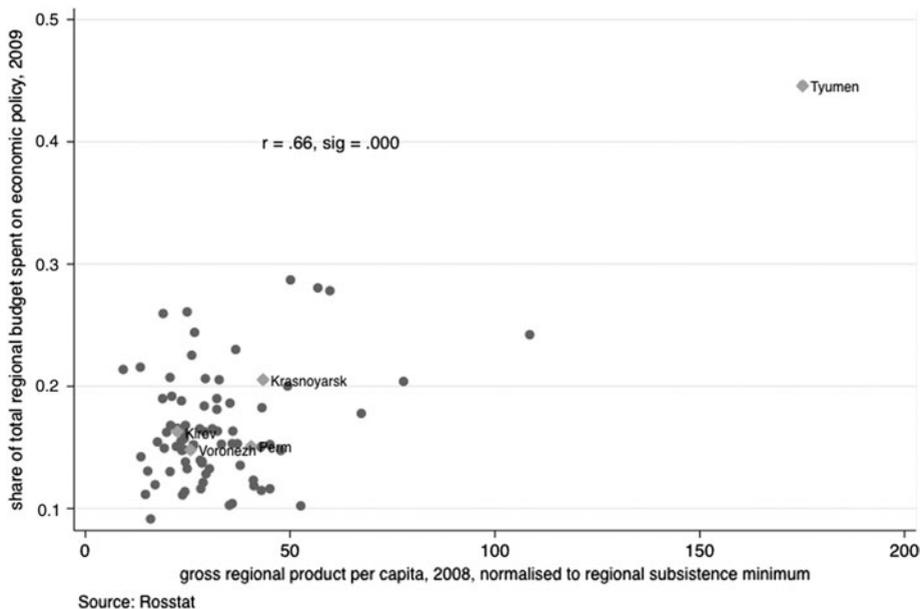


FIGURE 1. REGIONAL SPENDING ON ECONOMIC POLICY IS POSITIVELY CORRELATED WITH REGIONAL ECONOMIC OUTPUT.

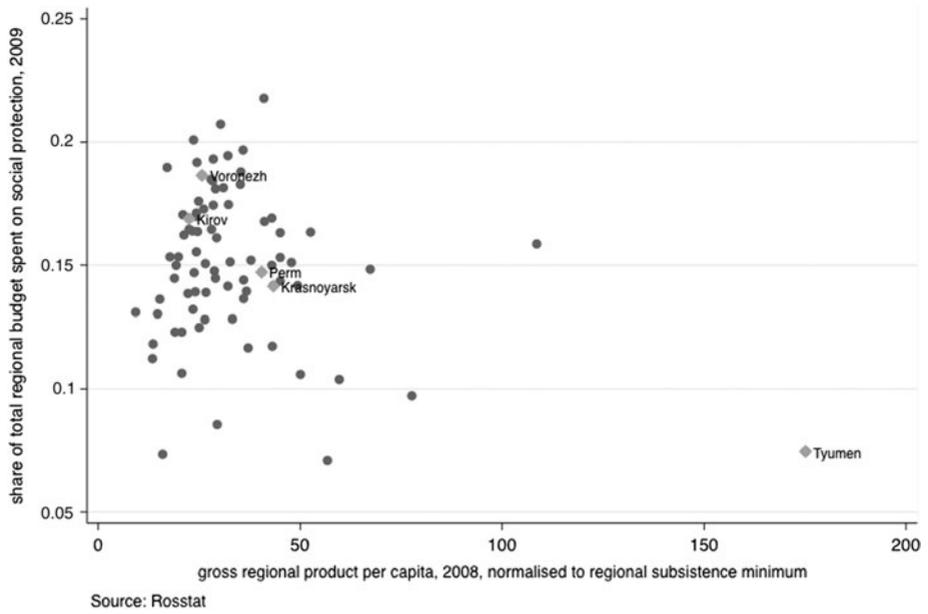


FIGURE 2. REGIONAL SPENDING ON SOCIAL PROTECTION IS NEGATIVELY CORRELATED WITH REGIONAL ECONOMIC OUTPUT.

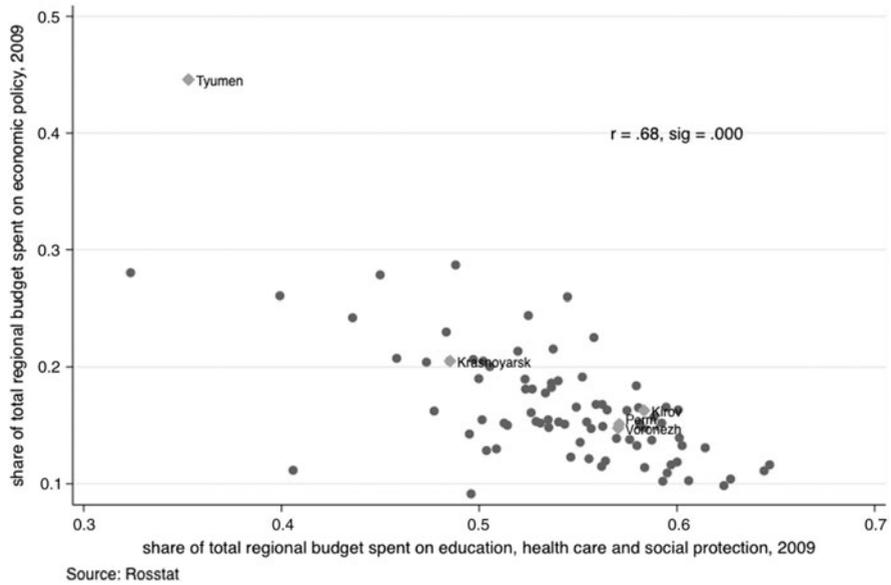


FIGURE 3. REGIONAL SPENDING ON ECONOMIC POLICY IS NEGATIVELY CORRELATED WITH SPENDING ON SOCIAL POLICY.

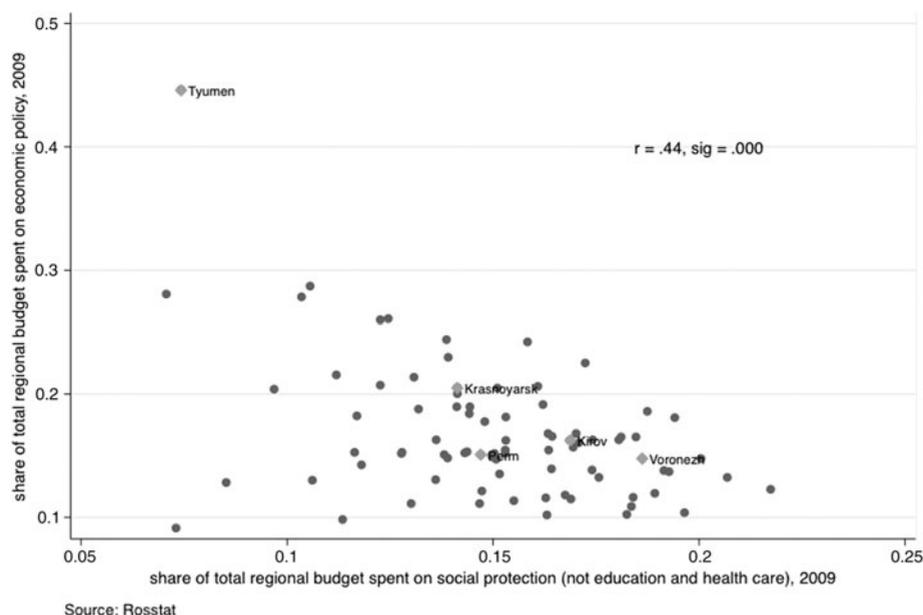


FIGURE 4. REGIONAL SPENDING ON ECONOMIC POLICY IS NEGATIVELY CORRELATED WITH SPENDING ON SOCIAL WELFARE.

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.³⁷

Governor Chirkunov has made the commercialisation 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.³⁸

There is a good deal of corruption as teachers, doctors and other public sector employees take advantage of the hybrid economic system. 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

³⁷Interview with P1, official in Perm' *oblast'* government centre for development of entrepreneurship, Perm', July 2010.

³⁸Interview with P12, professor at Perm' State University, Perm', July 2010.

from patients. Now everybody is earning this way but the quality of service has not improved. . . . 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.³⁹

Another example of an effort to use social policy for economic development purposes is the programme (also encouraged by Medvedev when he was president) to pay out unemployment benefits as a one-time benefit so that a recipient can open a small business. A senior official in charge of social policy in Kirov explained that: 'all the programmes that I [am running], programmes 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'.⁴⁰

A number of respondents declared that subsidising 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 programmes 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 programmes 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.⁴¹

An expert from Perm' commented:

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 4,000 rubles [per month]. And I understand the thinking of those people: why go to work for 5,000 if you can get 4,000 for doing nothing?⁴²

On the other hand, it is not only the poor who receive subsidies from government; business does as well. The economic crisis of 2008–2009 intensified business demands for subsidies and credits from regional government. Substantial federal funding was also distributed to regional programmes to maintain employment, stimulate entrepreneurship and subsidise businesses affected by the recession. An official of Kirov *oblast'* in charge of supporting entrepreneurship stated: 'Definitely, there are programmes. Something like 42 million rubles in *oblast'* money was allocated for the support of small business, legislation

³⁹Interview with KR15, deputy of regional legislature, Krasnoyarsk, August 2010.

⁴⁰Interview with KI2, vice-chair of government of Kirov *oblast'*, Kirov, July 2010.

⁴¹Interview with KR15, deputy of regional legislature, Krasnoyarsk, August 2010.

⁴²Interview with P11, professor at Perm' State University, Perm', July 2010.

was passed in support of small business; we brought in federal money. But in the end, it helped only modestly'.⁴³ 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. 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.

Regional governments often offer lower taxes on business in order to encourage investment. 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.⁴⁴

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 programme 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 programme 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.⁴⁵

In Perm', the grants programme for municipal projects uses a combination of regional and federal funding to encourage projects that will stimulate entrepreneurship. In Kirov, reflecting Belykh's emphasis on encouraging self-organisation on the part of civil society, two programmes promote local community development. In one, towns hold referenda on levying taxes to pay for specific projects, such as building a recreational facility. The *oblast'* budget matches local contributions ruble for ruble. Over half the towns in the region are participating in the programme. 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 subsidises as much

⁴³Interview with KI5, deputy chair of Kirov regional government, Kirov, July 2010.

⁴⁴Interview with KR10, head of the Department of Entrepreneurship in the administration of Krasnoyarsk *krai*, Krasnoyarsk, August 2010.

⁴⁵Interview with KR15, deputy of regional legislature, Krasnoyarsk, August 2010.

as 85% of the project costs. 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 (*khalyava*)’ (Belykh 2011).

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—characterised by highly competitive markets for labour 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, labour and government, reliance on consensual decision making, and high level of income security (Hall & Soskice 2001; Iversen, 2005; Iversen & Soskice 2006, 2009; Iversen & Stephens 2008). 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 universalistic and regressive nature of social entitlements) with elements of a somewhat skewed corporatism by which business interests are given access to policy making. There are elements as well of a liberal market-oriented economic policy of low taxes and low redistribution (as seen in the push to commercialise and privatise public services). This hybrid model of politics and economics allows regions to avoid radical and potentially destabilising shifts away from the universal social welfare system of the Soviet regime while slowly introducing elements of market competition for labour and social services. At the same time such a strategy is costly 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.

Regional governments in Russia, like the national government, face fundamental choices in their strategies for regional development. Creating a climate favourable for business investment comes at the expense of resources needed for other purposes, particularly for redistribution in favour 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 improve compensation for public sector employees indicates that the redistributive choices faced by governors are often resolved in favour, not of the poor nor of business, but of the public sector. Low tax collections, inefficient public utilities companies and weak financial markets all make these redistributive conflicts more acute than would be the case if tax receipts were more robust (as would occur if employers reported and paid taxes on a higher proportion of their actual earnings), if utilities providers were more efficient, and if financial markets could handle bond issues for infrastructure development bringing long-term returns. The short time horizons of economic agents reinforce these redistributive dilemmas.

So too do the institutional problems of the post-Soviet environment. Of all the sectors of society, it is business—the one new sector to arise in the post-socialist society—that has the

greatest capacity for collective action. 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. The fact that Russian employers still have a great deal of discretion over the terms of labour contracts with individual workers reduces incentives for workers to bargain collectively or for businesses to unite in bargaining with labour. Labour's low organisational capacity leaves business with only weak incentives to become a more effective collective actor. In turn, the fragmented character of both labour and business associations allows the state to remain the dominant player in setting economic and social policy.

Alleviating the redistributive dilemma between social and economic policy goals by inducing faster economic growth might be possible if institutions for coordination within the business and labour sectors were more effective and both could reach enforceable agreements with government. Then actors might be willing to pool the costs and gains from joint efforts to invest in infrastructure development, improved labour market regulation, training programmes that would match the skills of workers to the demands of new productive technologies, and financing for region-wide development plans. At present, however, at least on the strength of these four case studies, regional governments do not see such long-term institutional reform as a high priority.

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