

"New Far Eastern Policy": Institutions and Investments

P.A. Minakir

Economic Research Institute Far Eastern Branch Russian
Academy of Sciences, Khabarovsk, Russia
minakir@ecrin.ru

O.M. Prokapalo

Economic Research Institute Far Eastern Branch Russian
Academy of Sciences, Khabarovsk, Russia
prokapalo@ecrin.ru

Abstract— Trends and possibilities for implementing the state economic policy of the Russian Far East's development are discussed. A historical overview is given with the identification of stages of regional development, characterizing by the different sources and scales of economic resources, in particular investments, and the types and degree of localization of specific economic institutions for the regional development. It is shown that the solution of the region's economic development problem, uncompetitive from the point of view of standard market procedures but highly appreciated by utility from the point of view of national geostrategic and geoeconomic goals, is possible only if an effective combination of scales and sources of investment resources is found for the development of a region with adequate tasks type of institutional regime and with an optimal level of localization of institutions.

Keywords— Far East, investments, economic development, institutions, integration, priorities.

1. INTRODUCTION

The problem of the Russian Far East' economic development in the context of "integration in the Asia-Pacific Region" was put forward in the late 1950s in the form of the region economy export specialization concept. This concept was aimed not so much at extracting trade effects, but as attracting investments from abroad for the regional development. Actually, trade effects were also in demand, but had only local significance in the form of revenues from coastal trade. The export specialization concept was rapidly converted into political decisions, opening the way for attracting foreign investment to the Far East in the form of compensation agreements that stimulated the development of timber, fish, coal, gas production complexes in the region and somewhat improved the consumer market balance. In 1987 the ideas, forms and instruments of the regional economy's reorientation to the Eastern markets were further developed in connection with the transition of the USSR economy to market principles. that began, which required rationalizing the structure of markets for economic agents in the region, as well as the desire to find new sources of investment for the economic development not only of the Far East itself, but all national economy. An attempt was made to "deploy" the Far Eastern economy towards East Asia through the development

and implementation of the state program for the regional economic and social development. Since 1992, after the beginning of a radical economic reform, this program was dismantled. In a short time (by 1996) the Far East lost a significant part of its economic and population potential. There was a threat of an economic, and subsequently, political vacuum. During the five years of reforms, the gross product of the region fell by 58%, and the population - by 24% compared with 1991. In 1996, the long-term program was reanimated. But until the early 2000s, the lack of financial resources and the lack of incentives for economic agents did not significantly change the economic and social situation in the region. Only in 2000-2017 the situation has changed somewhat. But there is still no answer to the question of the reasons for the instability of the region's economic development, with periodic failures in the pace of development and the continuing lag in the level and quality of life. The article considers the assumption of the dependence of the pace and level of development of the region on the combination of the scale and structure of investment resources and the nature of institutions.

2. INVESTMENTS AND INSTITUTIONS AS FACTORS OF REGIONAL DEVELOPMENT

In general, for regions, economic growth and socio-economic development are not identical. One of the reasons is that the areas of creation and use of income are different. Therefore, when analyzing the problems of the region's economic development, it is necessary to take into account the interaction of capitalized income (created in the region itself and redistributed in its favor from the inter-regional system) with the quality of institutions that determine both the opportunities for the formation of internal development resources and the possibility of overflowing resources from outside. For regions such as the Far East, the national assessment of geopolitical and geo-economic utility is high with low competitiveness of economic agents located and functioning on its territory. The general rule is the chronic shortage of investments generated within the region. This is due to the small size of the available market, which blocks the economies of scale, and the limited opportunities to use the interregional market, since the specific labor and

capital expenditures are closing in the Russian economic space. Both of these problems could be circumvented within the framework of a planned economy through an extra-market redistribution of state resources in favor of the region. However, at the present time regional development is based not so much on the state as on private resources. The spatial resources' location is determined by purely market criteria. The regulation of resource flows is therefore possible only when adjusting the criterion values of costs and results by public policy instruments.

The state resources, which are also used for regional development, are, firstly, limited in nominal volume, and secondly, they are unstable in size due to a large number of spatial priorities for the state. These priorities' structure and intensity are subject to change due to political, geostrategic, social and other non-economic factors. The instability and the limited size of the state resources for regional development in the case of the Far East also have a purely economic basis - the state's obligation to maintain the stability of economic growth on a national scale. This fact requires concentrating the accumulation resources in regions with the maximum productivity of production factors [3]. Unfortunately the Far East does not belong to such regions and has never been treated.

The importance of state economic policy in conditions of limited state resources and non-competitiveness of regional economic agents determines the fundamental importance of the nature and degree of localization of institutions that ensure the achievement of the goals of the region's economic development. In the spatial economy for national and regional actors it is shown that economic development is largely determined by institutional regimes rather than by geography and natural resources[8; 10;2]. Institutions in terms of regional development are more important even than state investment support, since the latter in the limit may be completely absent. And then the only resource for development will be private investment, whose migration to regions with extreme economic conditions from the point of view of private business is determined exclusively by the nature and strength of institutions.

There are situations of almost complete absence of the latter, as shown below. Then the economic development of the region on the basis of endogenously generated resources is completely determined by the nature and impact of unified or local institutions. The "nature" of institutions means: 1) the ratio of inclusive (providing "favorable conditions for productive activities and effective application and accumulation of productive resources"), and extractive (providing the extraction of economic or political rents in favor of the economic and political elite) institutions [7]; 2) the ratio of compensatory (reducing the level of production, transport and transaction costs for economic agents operating in the region, thereby mitigating or eliminating economic barriers for interregional redistribution of private resources) and stimulating (providing favorable conditions for economic activity and general development conditions) of institutions [1;4].

3. INSTITUTIONS AND INVESTMENTS IN THE FAREASTERN DEVELOPMENT

In the development of the Russian Far East' social and economic system, we can share out some stages differing in terms of the pace, degree of complexity and sources of capital accumulation. Each of them is characterized by a peculiar combination of the institutional environment and the investment basis.

The first stage (1860-1918) was characterized as "*exogenous investments - localized inclusive institutions*". Investments were predominantly state-owned, and institutions were designed exclusively for the Far East. The institutional effects extended only to regional economic agents and their interaction with the external environment. It is the synthesis of the institutional regime with significant investments of public and private resources in the economic development of the region that could ensure rapid economic and demographic development of the region. During this period, an economic base in the Far East was actually created and an infrastructure framework was constructed. More than 1 million people from European Russia moved to the region.

The second stage (1922-1930) can be indicated as "*intraregional (endogenous) investments - localized inclusive institutions*". The main economic idea in this period was the recovering of the Fareastern economy after the Civil War. Direct public investment in the regional economy has virtually ceased, and the region's economy had relied almost exclusively on endogenous accumulation resources and net exports of economic agents. The disappearance of exogenous investments was offset by a significant increase and expansion of an inclusive institutional environment that stimulated and ensured the functioning of regional economic agents in exploiting the internal and adjacent foreign markets [5, pp. 142-152], which allowed high rates of development and quickly restored the pre-war level of economic development.

The third stage (1930-1990) demonstrated the interaction of "*external investments - extractive delocalized institutions*". The priority of the Far East in the allocation of state investment resources was restored. The region accumulated during this period an average of more than 7% of total investment in the economy of the USSR compared to 0.8% in the 1920s. This could not be achieved within the commercial criteria for allocating investment resources, as economic agents in the Far East remained uncompetitive in terms of both production costs and interregional exchange in the domestic market of the country. To solve this problem and to resume the large-scale resettlement program in the regions of the Far East, a new institutional environment was constructed that includes a system of extractive institutions that guarantee special conditions for the Far East in the field of pricing, planning, supply, sale of products, and income of the population. These institutions stimulated the migration of the population, ensured interregional exchange, guaranteed the sale of products and the supply of products of industrial-technical and social-consumer purposes to the region. This ensured a sharp acceleration of economic development,

structural restructuring of the economic complex and an increase in the population more than 5 times.

The fourth stage (1990-2002). Economic development in the region was based on the interaction "*endogenous investments - unified institutions*". In the logic of radical economic reform, a special institutional regime for the Far East was dismantled (with the exception of equalizing coefficients for wages). At the same time, state investment support for the region was discontinued. This led to a reduction in the region's economic potential by almost 70% (excluding the export-oriented segment of the resource-producing complex) and a large (by 24%) outflow from the region [5, pp. 357-378]. The attempt to form an inclusive institution in the form of "free economic zones" failed.

Fifth stage (2003-2018) metered "*state investments - localized extractive institutions*". The increase in the revenues of the state budget as a result of economic recovery after the financial and economic crisis of 1998 and the increase in the level of export prices for oil allowed to revive the national geo-economic goal, that is, the introduction to the commodity markets of East Asia. One of the conditions for achieving this goal is the socio-economic and infrastructural development of the Far East. Geoeconomic priority for Russia is important, since, especially after 2007, the actual market strategy in the macroeconomic sense was the replacement of the European raw materials market with East Asian ones. It was extremely important because the opportunities for an extensive increase in export rents in the European direction were almost exhausted, and the structural or technological opportunities for obtaining the increase in rent from the export of substitutes did not appear [6]. As a result, considerable state and corporate investment resources were sent to develop the main export infrastructure and strengthen the raw export base.

However, until 2012, these investment flows were not accompanied by the formation of new institutions that provide priority regional development. The result was the inability of the exogenous investment flows themselves to stimulate the economic and social development of the region due to the low level of localization of investment effects. The small size of the investment multiplier is due to the low level of diversity in the regional economy and the insufficient scale of intraregional demand. In addition, in the second stage of this period, the country and the region again faced a shortage of accumulation resources. In 2011-2016 years. the volume of aggregate investments in fixed assets in the region was reduced by an average annual rate of 8% and, in aggregate, was reduced by 35% [9].

This led to efforts to implant new development institutions, including the territories for outpacing socio-economic development, such as a free port, certain tariff preferences, some measures to increase the involvement of the population, "the Far Eastern hectare", the centralization of financial subsidies [11, pp. 304-327]. However, these institutions are mainly localized and, moreover, are of a sub-local nature, spreading only to limited territories within the region, thus not solving the problems of no competitiveness of regional producers outside the local zones. But mechanisms for

translating economic effects beyond these "institutional harbors" are not created, which blocks the systemic effect of regional development. Table 1 synthesizes macroeconomic responses of the ratio of sources and scales of investment, on the one hand, and the nature of institutions, on the other. As follows from the correlation of macroeconomic responses and the combination of "investment / institutions", the best combination is the existence of inclusive institutions with the maximum value of exogenous investments in the economy of the region. Accordingly, the worst combination in terms of economic effects is the effect of unified institutions with the maximum share of endogenous investment.

Table 1. Interrelation of economic effects and investment-institutions correlation

| Indicator | Inclusive Institutions | Extractive Institutions | Unified Institutions |
|------------------------|------------------------|-------------------------|----------------------|
| Exogenous Investments | +++ | ++ | +/- |
| Endogenous Investments | ++ | + | --- |

Note: "+" - the degree of incremental and structural positive effect, "-" - the degree of negative effect

CONCLUSION

The shortage of investment resources, on the one hand, and the weakness and instability of institutions on the other, hamper the transformation of the Russian Far East into the economic and humanitarian outpost of the country in East Asia. In recent times, the reduction of the federal budget's ability to invest in regional development can be compensated only by increasing private investment. But the latter are guided by the presence or high probability of obtaining economic, especially foreign trade, rent, which could compensate for objective rise in price of factors of production and increased transportation costs. Objectively, this situation exists in the sector of an export-oriented extractive industry. The rest of the economic complex and, especially, the social sphere need non-commercial investment or in the creation of a special institutional environment. Such an environment should ensure: 1) stimulation of entrepreneurial and investment activity of economic agents operating in the region; 2) compensation of factors that are rising in price and services, and a radical decrease in transaction costs for functioning and potential economic agents in the region; 3) unification of institutional regimes in the region and in adjacent economies; 4) state guarantee of maintaining humanitarian, social and communal standards in the region at a level ensuring the comparability of the quality of life in the region and neighboring countries. And this environment should be based on the construction of stable inclusive, delocalized institutions. Since 2012 the construction of a special institutional environment began in the Far East. However, there are two problems that block the expected

effects in perspective in terms of the growth of macroeconomic scale and structural results. First, the institutions being constructed are not inclusive, but extractive, and localized. Secondly, the scale of exogenous investments in the regional economy in terms of size and structure is insufficient in terms of obtaining the expected systemic effects.

References

- [1] Anderson J.E. Economic Integration and the Civilizing Commerce Hypothesis // *The World Economy*, vol. 31(1). (2004).
- [2] Frolov D.P. Do Institutions Matter in Spatial Economics? // *Spatial Economics*, № 1, pp. 14-37. (2015).
- [3] Isaev A.G. Public Investment as a Determinant of Economic Growth of the Russian Regions // *Regionalistika*, vol.1. № 4, pp. 61–72. (2014).
- [4] Mill John Stuart. *Basis of Political Economy*. Vol.3. Moscow. Progress (1981).
- [5] Minakir P.A. *Region's Economics. Russia Far East*. Moscow. Ekonomika (2006).
- [6] Minakir P.A., Prokapalo O.M. Russian Far East: Economic Phobias and Geopolitic Ambitious // *EKO*, № 4 (514), pp. 5–26. (2017).
- [7] Natkhov T.V., Polischchuk L.I. Political Economy of Institutions and Development: The Importance of Being Inclusive // *Journal of the New Economic Assotiation*, № 2, pp. 12–38. (2017).
- [8] North, D. C. (1990). *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press.
- [9] Prokapalo O.M., Isaev A.G., Mazitova M.G. Economic Situation in the Far Eastern Federal District in 2016. // *Spatial Economics*, № 2, pp. 138–173 (2017).
- [10] Rodrik, D., Subramanian, A., and Trebbi, F. Institutions rule: The primacy of institutions over geography and integration in economic development // *Journal of Economic Growth*, 9 (2), pp.131–165. (2004).
- [11] *Russian Far East on the Way to Future*. Ed. by P.A.Minakir. Khabarovsk: ERI FEB RAS. (2017).