Introduction

The New Russia has achieved considerable growth in the seven years following the 1998 debt default, ruble devaluation and economic crisis. Political stability, strengthened economic institutions, and high oil prices, coupled with significant import substitution and export competitiveness, have contributed to Russia's strong economic growth. The Russian authorities have maneuvered the levers of fiscal and monetary policy adeptly, at the same time introducing a flat income tax rate and reducing import tariffs, with further external liberalization anticipated in the context of the envisaged WTO membership. EU accession of eastern European countries has caused only modest trade diversion in the short run, since the growth-enhancing effects of EU membership tend to stimulate overall imports of accession countries, and Russia thus stands to benefit through growing exports. Moreover, there are new opportunities to import modern machinery and equipment from eastern Europe. At the same time, Russia looks towards Asia, where China is increasingly becoming a new economic gravity center. While China's expansion is trade creating in Asia (including Russia), it is more doubtful whether Russia is not suffering from foreign direct investment diversion in a period in which China continues to attract massive FDI inflows, not to mention that Russia's FDI policy regime greatly needs improvement in its own right. Moreover, Russia will have sustained economic growth only if the expansion of the oil and gas sector is accompanied by solid growth of a modern manufacturing sector for which capital accumulation and innovation play a crucial role. If Russia does not achieve a diversified production and export structure, it could face serious long run problems if there is a sustained current account surplus which translates into a real appreciation of the currency. There remains, therefore, a fundamental challenge for Russia's economic policy-makers: implementing economy-wide, cross-sectoral structural reforms and building durable market institutions that will transform the Russian economy into one that is flexible, diversified and integrated, not only domestically but also internationally.

There is little question that Russia has made significant progress in dismantling the central planning system, which, during the Soviet era, had directly governed Russia's industrial structure, conduct and performance. But, to date, the development of these basic market institutions to take the place of central planning remains nascent – especially in regional markets, where day-to-day business transactions are actually conducted. This is the principal factor making the costs of doing business in Russia excessively high and impeding enterprise formation and restructuring. While there has been much debate as to why – at the national level – the restructuring of Russian enterprises has been partial and new private sector start-ups are struggling to emerge, little systemic analysis has been carried out to assess the state of basic market institutions in Russia's regions. The paper by

Harry G. Broadman helps to fill this gap. His analysis focuses on the business environment of 13 of Russia's 89 regions and examines four key issues that Russian firms face in carrying out business transactions: (i) the state of inter-enterprise competition; (ii) the regulatory regime governing the delivery of infrastructure services (with a focus on the telecom and Internet sector); (iii) the sources and use of corporate finance; and (iv) the efficacy of the court system in fostering the settlement of commercial disputes. The paper formulates policy recommendations for each of the areas analyzed, and in so doing sheds light on salient inter-regional differences in existing policy frameworks and in the structure and nature of the country's enterprise sector, as well as on how regional governments and firms both respond to and shape these differences.

As regards economic opening up of Russia it is obvious that there is a considerable expansion of the tradables sector, but there also is high unemployment and a special role of the natural resources sector. Paul J.J. Welfens takes a closer look at some of the key issues of opening up and growth in a resource-based economy. Moreover, the focus is on the Balassa-Samuelson effect, the role of innovation in the Mundell Fleming model and key aspects of long run exchange rate dynamics. The analysis shows that the role of unemployment and innovation should be integrated in the standard analysis of economic opening up and growth.

Evgeny Gavrilenkov's contribution is on the role of reforms for long run growth and the problems of low monetization of the Russian economy on the one hand, on the other hand his focus is on issues of political governance and the efficiency of government spending. Russia's macroeconomic prospects are favorable as long as there is sustained investment dynamics and a growing monetization of the economy. In this respect, Russia has achieved considerable progress. Gavrilenkov also analyzes the structure of the revenues and expenditures of the Russian government. Financial sector development will remain a major challenge on the agenda, and the new Russia will have to cope both with financial market volatility and considerable oil price dynamics.

The higher the degree of Russia's economy – with international links through trade, foreign investment and portfolio capital flows – the higher the exposure of Russia to the global economic dynamics; and with Russia growing strongly the economic weight of the country in the world economy is growing. Hans Gerhard Strohe and Noer Azam Achsani analyze the interdependency of fluctuations between Russia, Europe, Asia and the US. Methodologically they use correlation analysis, Granger causality and VAR analyis. The various approaches suggest different patterns of international interdependencies. It is quite interesting to see not only how Russia's economic development is dependent on international impulses but also to understand the role of Russian economic shocks for eastern Europe.

Similar to Russia the Ukraine has experienced economic and political transformation where the country's recent political developments emphasize the role of democracy. Both countries have not only major international economic relations with the EU25 but also with the US: Trade and capital flows play an important role where part of US foreign direct investment in both countries actually comes from US subsidiaries in the EU. Hence the extensity of US links with Russia and the Ukraine is often underestimated. Olga Nosova analyzes the links between the