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ECONOMIC DEVELOPMENT OF CRIMEA AFTER MARCH 2014

Master's Thesis

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Master Thesis Proposal

Topic Characteristics:

My thesis will focus on the impact on the Crimean economy made by its integration in Russia.

This is a very interesting political economy case-study, which allows us to monitor the process of economic development in the region, plagued by the inherited economic imbalances and the questionable legal status. In other words it allows seeing how underdeveloped territory ascends to the more developed country (like GDR to FRG) while at the same time bearing characteristics of disputed territory (like Northern Cyprus).

Up to the moment all studies on Crimea in the period that followed its annexation focus on political side of this question (Darczewska, 2014; Jenkins, 2014; Gardner, 2015; Grigas, 2016). I am not aware of any other economic studies of this subject existing at the moment; so essentially, it is first research of its kind.

I believe this subject to be important and relevant because the studied region has the following characteristics: it is huge in size of territory and population; it is important in political sense – its annexation has sparked major international crisis. There are economic researches about unrecognized territories like Northern Cyprus or Israel's settlements on the West Bank – so it is justified from scientific point of view to write a research about Crimea.

Hypothesis:

- 1) After more than 20 years of primarily negative economic development on the peninsula gap between Crimea and the Russian mainland regions have increased, making it difficult to achieve convergence;
- 2) Already present negative features of Crimea's economy coincide with the new factors, such as sanctions, thus creating a negative effect on the most of the sectors of economy;
- 3) In its approach towards development and integration Russia puts an accent on the huge investments, rather than building institutions – at the same time all economic development in Crimea depends on the subsidies and crisis management from the mainland;

4) After 2 years of being part of Russia de-facto, Crimea did not reach full integration – because of the lack of proper infrastructural connection to the Russian mainland and the sanctions that prevent major Russian companies and banks from engaging directly in the business in Crimea.

Methodology:

- 1) Search for relevant theories and empirical evidences in the following areas: economic integration; disputed territories; small island economies; institutions; Russian regional economic development;
- 2) Study the patterns of Crimea’s economic development before March 2014 by analyzing it sector by sector; drew comparisons with the south of Russia and explain differences in the models of development;
- 3) Analyze the changes in the different sectors of Crimean economy that took place after March 2014 with respect to what we have discovered in the previous parts of the research.

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Abstract:

This paper researches the changes that took place in Crimean economy after March 2014 with respect to the integration policies Russia has applied in that field. Based on the theories of economic integration and Russian regional development programs, economic development patterns of disputed territories and small island economies, as well as the influence of institutions on the economy, we find that ascension to Russia had for the peninsula its positive and negative effects with the prevalence of the latter. We also suggest that the political integration of Crimea was more successful than it was in economic dimension, because the existing investment constraints and lack of proper connection to the Russian mainland remain formidable obstacles on the way of region's successful integration and further development. We find that all economic development in Crimea depends on Russian subsidies and it is likely to remain this way because the region is underdeveloped by Russian standards. This is consistent with the idea that small island economies and disputed territories are over-dependent on the respective sponsor-state for the provision of economic stability.

Abstrakt:

Tato práce se zabývá změnami, které se odehrály v krymské ekonomice po březnu 2014 s ohledem na integrační politiku Ruska uplatňovanou v této oblasti. Podle mého názoru, zakládajícím se na teorii hospodářské integrace a ruských programech regionálního rozvoje, vzorech ekonomického rozvoje sporných území a malých ostrovních ekonomik, ale také na vlivu institucí na ekonomiku, mělo připojení poloostrova k Rusku některý pozitivní, ale více negativní

vliv. Politická integrace Krymu byla úspěšnější než integrace v ekonomickém směru, protože stávající investiční omezení a nedostatek odpovídajícího napojení na ruskou pevninu tvoří i nadále obrovskou překážku v cestě k úspěšné integraci regionu a k jeho dalšímu rozvoji. Dá se říci, že je veškerý ekonomický vývoj Krymu závislý na ruských dotacích, a je pravděpodobné, že to tak zůstane i nadále, protože je region na ruské standardy nedostatečně rozvinutý. To potvrzuje také teorie, že malé ostrovní ekonomiky a sporná území jsou příliš závislá na příslušném sponzorském státu, který jim poskytuje ekonomickou stabilitu.

Klíčová slova: Krym, integrace, ekonomik, Rusko, sporná území

Keywords: Crimea, integration, economy, Russia, disputed territories

Range of thesis: 142 pages, 24988 words without bibliography.

The thesis conforms to the requirements for a Master's thesis

..... (Signature of the supervisor and date)

Admitted for the defence..... (Date)

Head of Chair: (Name, signature and date)

Chairman of the Defence Committee.....
(Signature)

The thesis is 24,988 words in length, excluding Appendices.

I have written the Master's thesis independently.

All works and major viewpoints of the other authors, data from other sources of literature and elsewhere used for writing this paper have been referenced.

..... (Signature of the author and date)

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Introduction

In March 2014 Crimean peninsula, after a short period of being a separatist state and a referendum supported by Russian armed forces, became a part of Russian Federation.

International community recognized neither the referendum, nor the de-facto ascension of the region to Russian Federation. This event has sparked major international crisis that remains unsolved to that date.

Annexed Crimea makes an interesting political economy case-study because of its size and importance: it's a large region with more than 2 million people of population; Crimea is located in strategically important region of the Black Sea and it serves as base for Russian power projection in the region; it was annexed and incorporated by G20 economy and UN Security Council member. Bulk of the existing literature on Crimea after annexation focuses on political aspect of the problem, but the economic side of developments in annexed Crimea remains overlooked. Such neglect is not understandable in the light of research interest presented by this subject – economic development of annexed Crimea is arguably one of the most attractive topics in the post-Soviet studies, which remains under-researched to that date. In support of this view we can point to the examples of other disputed territories like Northern Cyprus, whose population, size of economy and geopolitical impact are not bigger than Crimea's – but all of them were studied from economic perspective.

Studying Crimean economic development today is justified from scientific point of view – 2 years is the time-span that offers enough possibilities for all sorts of data sources to appear, be it independent expert assessments or reports by international bodies. Qualitatively new sources of data are not likely to appear in the near future and all further researches in that direction will have to make use of sources, which are available now.

The aim of this dissertation is to study the economic development of Crimea during period from March 2014 to March 2016, when the region was undergoing integration in Russia economy.

This time period was chosen because it exceeds official transition period that has ended in

January and allows seeing some lasting tendencies, which are not usually visible in the shorter period of observation. 2 years is just enough to get information for a few comparable seasons, which analysis will allow making scientifically-grounded conclusions. It can be argued that greater period of time is needed so study this subject, but there is a counter-argument that any further hesitation will result only in unnecessary time loss. For example, there are already scientific articles, studying the impact of Ukrainian crisis on the Russian stock exchange market (Nivorozhkin and Castagneto-Gissey, 2016). Existing data with all its imperfection allows researching this subject thoroughly and drawing conclusions, which may be later used in that field.

Our research question sounds the following way: how economic integration of Crimea in Russia has affected its economic development in the first years after annexation. We argue that integration and development in this time frame were inseparable from each other because process of adaptation and adjustment of Crimean economy to Russian conditions correlates with its performance and there is a strong causation link. For example, real estate sector was given boost impossible in Ukrainian conditions, while banking sector shrunk and degraded under new circumstances.

Our method is described as following. First, to outline the relevant archetypes of economic development present in 4 different types of economic subjects, that are relevant for our research purposes: integrated regions; disputed territories; small-island economies; Russian regions that went through development programs. Additional part of theory we use is dealing with the economic impact of institutions. Second, to explain described developments that were present during studied period with reference to the archetypes of economic development we will examine in theoretical framework. Third, to draw conclusions based on the summary of our findings.

The structure of the work is following:

- 1) Chapter 1 deals with theoretical framework and the sources we have used:
examination and outlining of archetypes relevant for our research goals;
- 2) Chapter 2 will explain economic development of Crimea before March 2014 – sector by sector. It is needed to highlight later changes that occurred, as the whole trajectory of development changed overnight. Comparison with neighboring Russian region of Krasnodar will be presented and explanation of differences will be provided – it will serve to the purpose of our later examination of Crimean economy and will help to explain why economic development and integration of the region later took the form of catching up with the rest of Russia;
- 3) Chapter 3 will describe and explain changes that took place in Crimean economy during the studied period with the reference to archetypes of development noted earlier;
- 4) In the conclusion findings will be summarized.

Chapter 1: Theoretical framework and literature review

Most of the existing literature on Crimea is centered on political side of the affair (Darczewska, 2014; Jenkins, 2014; Gardner, 2015; Grigas, 2016), hence theory had to be built from elements, that would have relevance in our case.

1.1 Economic integration. First thing we need to do is to examine the question of economic integration, because in the observed period Crimea was being integrated in Russia and both processes were inseparable from each other.

We have used theoretical literature on the subject. Mattli (1999) provides good overview of integration efforts through history: in Europe and on other continents. Principal thought for our research, based on the analysis of all integration efforts, is that the further economic integration and convergence between regions, existing on the different stages of development ultimately depends on political decisions made by the actors involved. This corresponds to one of our main ideas that the drivers behind Crimea's economic performance are more of political, than of pure

economic nature. Rosamond (2000) have dedicated 3rd chapter of his work to the discussing the integration theories (pp. 50-73) with paying special attention to neo-functionalism which is relevant in our case because some of its elements are consistent with what we will see in case of Crimea and Russia, which were very dependent on each other and by the moment of annexation still had had very tight economic ties: economic foundations to the integration and the political agenda supporting integration efforts. According to Mattli and Rosamond, any kind of deep integration rests upon already existing strong ties between regions involved and the political willingness of the respective leadership to strengthen these ties. These factors were evident in Crimea – historical dependency of the peninsula on the demand generated in mainland Russia and the politically motivated decision of Kremlin to invest in the development and integration of the region.

Additional attention needs to be paid to the parts of integration theory that relate to the investments, made by more developed regions to ensure catching up of the least developed regions. As we will see later, successful integration and development of Crimea depends on large investments from Russia – primarily in infrastructure. In this case it would be of use to support this thesis with the examination of similar experience elsewhere. EU cohesion policy would be perfect for this purpose. Leonardi (2004) and Molle (2008) offer comprehensive overview of EU programs aimed at the promoting convergence between more developed core states of EU and its more recent and relatively less developed new member states. The existing evidence suggests that enhancement and acceleration of economic integration between regions different in their levels of economic development demands sufficient investments from more developed regions. With respect to Crimea we conclude that Russia's plans for infrastructural investments already affect regional economic development and will affect it even more in the future – the existing evidence from EU cohesion policy experience confirms the idea that such investments have positive effect (Bachtler and McMaster, 2007; Farole et al., 2011; Medeiros, 2013; Rodríguez-Pose and Garcilazo, 2015), though on condition that allocation of funds is effectively supervised

(Beugelsdijk and Eijffinger, 2005). The principal conclusions in this part of our theoretical framework should be that economic integration and convergence of different regions demands the following:

- Long-term political commitment;
- Large investments in order to achieve certain level of convergence between regions, which exist on a different level of economic development.

There is however a very limited use of the literature we mentioned because all of it deals with the integration between different countries, which are politically independent from each other and choose to enhance cooperation. This is not the case of Crimea which was part of one country and then became a part of different one. Since the studied region have changed previous jurisdiction and its existing governance hierarchy have shifted to the different sovereign actor, there is a need to study how newly integrated regions develop on a nation-state level.

To further narrow the scope of the research and evade dealing with huge number of suppositions and admissions, irrelevant to the research, examined period for examples will be limited to post-WWII period – otherwise we will have to deal with such political-economic constructs as colonies and protectorates. The fact that Crimea is the first single annexation in Europe after WWII gives us more ground for this specification.

To the date there are few cases fitting our criteria – Germany (integration of GDR) and India (annexation of Goa and Sikkim):

- 1) Former GDR. There is no shortage of literature on this subject. Available sources can be classified in several groups: the ones examining development of the region on the first stages of integration, examining differences between two states (Siebert and Collier-Jr., 1991; Siebert et al., 1991; Sinn, 1992); those explaining integration issues in retrospective (Sinn, 2000; Burda and Hunt, 2001; Burda, 2006); papers, dealing with separate sides of reunification such as labor market fluctuations (Lechneret et al., 2005; Snower and Merkl, 2006; Uhlig, 2006), regional changes (Büttner and Rincke, 2004;

Redding and Sturm, 2005), improvements in living standards (Frijters et al., 2004; Frijters et al., 2004 – 2; Easterlin and Plagnol, 2008) and impact of specific factors such as social connections on integration (Burchardi and Hassan, 2011).

Germany has the most relevance in this relation because FRG had to deal with integration and development of a much less developed territory. «German reunification is paradigmatic of the economic integration of any two neighboring regions at different levels of economic development» (Burda and Hunt, 2001, p. 2). Approach, taken by Germany, is the closest to what could be later examined in Crimea: heavy subsidizing and other benefits aiming towards full convergence of the new region with the rest of the country. The fact that Eastern Germany's integration with FRG happened more than 20 years ago allows to make projections about Crimea's own trajectory of development – it is consistent with our hypothesis that full integration will take a long time and that region will remain less developed in comparison with the rest of Russia, like former GDR still has to catch up with the west: FRG's success in narrowing the gap between two regions was relative: by 2013 former GDR territories still had weaker industrial base, lower income and higher unemployment levels (Bracholdt, 2013); regional GDP levels in 2013 making up 70% of the Western Germany levels, while federal subsidies still play an important part in regional economy (Wagstyl, 2013). Big subsidies and other expenditure policies also play crucial part in Crimea's development and integration with Russia, so Germany is the good case-study for our research.

- 2) Goa and Sikkim. For Goa chosen sources can be grouped in the following categories: those dealing with general economic overview of the region (Newman, 1984; Giri, 2009; Do Ceu Rodrigues, 2009; Urankar, 2013) and particular important industries such as mining (D'Mello, 2015), agriculture (Vanjari, 1969; Rubinoff, 2001), tourism (Routledge, 2000). The same division can be applied to literature about Sikkim: general overview (Gupta, 1975; Karan, 1987) and analysis of certain industries – which in case of

Sikkim is limited to agriculture (Arora, 2007 and 2008; Chakrabarti, 2010; Tambe et al., 2012).

Sikkim and Goa are relevant because the few details of their ascension to India and further development make parallels to Crimea: they were obtained with the use of military force; visible presence of tourist sector; entrenchment of local governing elites; redistribution of land and other resources, that hurts minorities; their economic development depended on provision of investment schemes and other economic incentives by the federal center. The differences were solid too: their international status of integral part of India was not challenged; their economic development after ascension to India was based on the switch from agriculture as the main form of employment to other sectors; these regions were less dependent on the federal subsidies.

To sum up this part, we have found evidence that in similar cases political commitment and generous investments (even when the ascending region is more or less developed – like Goa) are necessary conditions for the economic integration of the new region.

1.2 Disputed territories. International status of Crimea is one of the important factors of its economic development; hence addressing researches in that area would be of use for our research. The closest analogy to Crimea would be unrecognized states and annexed territories. For the purpose of determining what an unrecognized state is we used general literature on the subject of unrecognized states to extract the characteristic features of such kind of territorial entities (Baev, 1998; Pegg, 1998; Lynch, 2004; Kolsto, 2006; Rywkin, 2006; Stanislawski, 2008; Caspersen, 2012). Such are the following:

- Unrecognized state covers most of the territory it claims, including its main cities;
- It lacks broad international recognition;
- They have large risks of resumption of the armed conflict around their status;
- Such entity has to exist in the status it claims for some period of time – minimum 2 years.

This is an argument, shared by 2 researchers (Kolsto, 2006; Caspersen, 2012) and serves

as additional support for our choice of topic, because 2-years span is the current time of Crimea being outside Ukraine.

Mentioned sources deal with the political side of the question, while we are interested in the economic development of unrecognized states. Most of the research in that narrow area is country-specific, so we can refer only to one particular article by Martin Riegl, an expert on the issues of such states (Riegl, 2014), which concludes that lack of recognition alters their economic development to the worst. Such conclusion alone is obviously not enough for further use and we had to take some country-specific studies that suit our purposes.

To choose among huge amount of various separatist groups and unrecognized territorial entities, we needed to establish certain criteria for comparable territories, which would meet our research purpose – to examine Crimea’s economic performance after its annexation by Russia:

- Fitting the crucial criteria of such entities – control over most of claimed territory and de-facto political independence from the country from which it ceded;
- Having a sponsor-state – like Crimea in its current status could exist only with Russian support, so the studied analogue has too;
- Studied unrecognized entity should exist up to the date – we are unaware when or if Crimea will become the integral part of Ukraine again, hence the analogous case had to be present as continuous, not as something accomplished;
- Studied unrecognized entity must lack wide international recognition or the history of such.

With having this criteria we were able to concentrate on studying 5 unrecognized states (Transnistria, Abkhazia, South Ossetia, Nagorno-Karabakh, Northern Cyprus) and 2 annexed territories (Israeli territories on the West Bank, Western Sahara).

Here we will shortly discuss the chosen case-studies and the relevant literature:

- 1) Abkhazia and South Ossetia. General information about economic life in these states was found in the general researches on the unrecognized states in the region (Popescu, 2006; Kolosov and O'Loughlin, 2011; Bakke et al., 2014).
- 2) Transnistria. Literature can be divided in the following groups: functioning of the economy (Burla et al., 2005; Chamberlain-Creanga and Allin, 2010; Allin, 2011; Isachenko, 2012; Balmaceda, 2013; Bakke et al., 2014) and external economic interactions of the region (Popescu, 2006; Luecke et al., 2011; Prohntichi and Lupusor, 2013; O'Loughlin et al., 2013).
- 3) Nagorno-Karabakh. Economic development of Nagorno-Karabakh has attracted less attention than the political aspect of this unresolved conflict, but some literature still exists. There are general papers, dealing with region's economic circumstances (Sharrow, 2007; Terterov and Niculescu, 2012) and articles concerning the political aspects of the problem, but providing valuable insights into its economic life (Potier, 2000; Champain, 2005; Kolsto and Blakkisrud, 2008; Hopmann and Zartman, 2013).
- 4) Northern Cyprus. There is no shortage of researches, which could be structured in 2 groups: those examining economic dependency of the region on its sponsor-state (Gunsel, 2006; Feridun et al., 2011; Feridun, 2014) and those dealing with region's overall economic performance (Özyigit, 2008; Mihci and Karaman, 2009; Katircioglu, 2010; Isachenko, 2012; Gorgulu, 2014; Karavelioğlu, 2014; Yorucul and Mehmet, 2014).
- 5) Israeli territories on the West Bank. This is the subject with the bigger number of researches. Most of it deals with explaining political economy of settlements (Arnon and Weinblatt, 2001; Farsakh, 2002; Lagerquist, 2003; Roy, 2004; Khalidi and Taghdisi-Rad, 2009; Hareuveni, 2010; Hareuveni, 2011; Kanafani and Ghaith, 2012); economic consequences of occupation (IMF, 2010; PMNE and ARIJ, 2011; UN, 2012; Koek, 2013; World Bank, 2013; World Bank, 2015; HRW, 2016); place of Arab parts in the economy of occupied territories (Farsakh, 2002 – 2; Rosenhek, 2003; Gordon, 2008; Khalil, 2009;

Ryder, 2013; WPO, 2013); external economic interactions of the occupied territories (FIDH et al., 2012; QCEA, 2012; World Bank, 2012; Tonutti, 2013; Lovatt and Toaldo, 2015); some chronological works on the development of settlements (Gorenberg, 2007; Zertal and Eldar, 2009).

- 6) Western Sahara. Morocco de-facto administers this region, though its international status is questionable and remains disputed. The level of economic development of the region is not very high in comparison to other studied regions and it did not attract attention of economic researchers, so the relevant information had to be drawn from political briefs (Lamadieu, 2012; Arieff, 2014;) and the articles from the editions specializing on the regional studies (Rubin, 2015).

From what we could learn out of these examples, we will outline the most common patterns of economic development of such territories to use them later to explain described changes in Crimean economy. There are 2 groups of factors, affecting economic development of all of these studied territories: external and constructional. First one means those imposed by country supporting their existence or by outside actors, the second describes natural structural traits accompanying their development.

External factors:

- Economy of disputable territories could exist and develop only with the help of sponsor-state;
- The legal position, recognition and de-facto status of newly annexed or absorbed territories depends on capability of their sponsor-states to negotiate and ensure their existence;
- Economy of unrecognized territories is vulnerable before external political factors, such as war and sanctions – all of the examined regions had suffered from these in different times and in different ways.

Constructional factors:

- Unrecognized territories have serious problems with the establishment and nostrification of property rights due to the violent nature of events preceding their founding;
- Such territories suffer from disruption in legitimate trade and investment;
- They are still able to establish de-facto presence in the world economy by informal and illegal means. As we will later see from Crimean example, economic activity on such territories remains connected to the economies of region, though in formally illegal way;
- Such territories usually have booming shadow economy, sometimes due to the criminal nature of the state, sometimes due to the need to find substitution for the otherwise absent goods and services;
- All unrecognized entities have some population group supporting their de-facto status – it could be those who took part in militarized secession or those who benefited from the later privatization or other forms of economic redistribution.

Some attention will be paid to the Crimean Tatars community because they played pivotal role in the blockade of Crimea (which was disruptive to some of the sectors we observe) and they play important role in the development of the constructional sector. There are works studying this community in historical perspective (Fisher, 1978; Uehling, 2004; Williams, 2015), which are good for building an understanding of the principal problems this community faces and the issues it has with the central government on the mainland (in the periods we highlight that would be Ukraine and Russia). There are certain problems this community encounters on the peninsula since March 2014 and as we will see later – most of them already were present during the Ukrainian period. In political science Michael Mann tended to explain common phenomenon of ethnical discrimination as the part of the process of transition: societies which are happening undergoing change from totalitarian regime to democracy are inclined towards discriminating and attacking minorities, which were actually or allegedly connected to the fallen regime (Mann, 2004). In economic sense this theory can be applied to many communities, that have suffered in the process of transition – such occasions took place in the most of our examples from the

integrated regions and questionable entities, with the only exception of former Eastern Germany. In case of territories with questionable status possible explanation could be that what first seemed as temporary state became a status quo – which due to the reasons explained above was tolerable to minorities much less than the immediate aftermath of occupation: the new socio-economic reality became stronger and occupants entrenched economically, making it clear that discriminative policies and unfair practices are to stay. It accelerates if minority is not accepting new political order – which is true in case of Arab population in the West Bank, displaced Georgians in Southern Caucasus separatist republics, Greek Cypriots from the north or even Lepchas in Sikkim and some distant rural communities in Goa. In case of newly integrated territories it would be economical issues: in Goa and Sikkim economic interests of the elites of the territory which exists in the new political reality sooner or later colludes with interests of smaller group – like rural communities in India. The minority does not have to be ethnical in principal, though it is the form of discrimination we can encounter more often than other ones. Taking into account all of that, we argue that community's problems on the peninsula have primarily economic reasons at the roots.

1.3 Small island economies. As peninsula Crimea is connected to the continent by land, after annexation it became de-facto an island because it has land border only with Ukrain. Crimean economic model traditionally has shown over-dependency on the mainland. Issues of integration and international status of Crimea are not fully explaining the natural weaknesses of this region, which were present in its economy before annexation and influence it now. Also, as we will see later, Crimean economy has many features of small island economies:

- It is dependent on the mainland in economic sense: it needs demand generated on the mainland, investments, steady supplies of raw materials and energy etc.;
- Tourism plays an important role.

This issue was well-researched, so in order to take out only the most relevant sources, generalized works were analyzed. One of the best resources was Professor Lino Briguglio, the

specialist on the small island economies. His works and the ones written in collaboration with other authors are examining vulnerabilities facing such economies (Briguglio, 1995; Briguglio, and Galea, 2003; Briguglio et al., 2006, 2009, 2010) and they lead to conclusion that small island economy cannot survive without mainland. Other researcher, Professor Jerome L. McElroy has written on the subject himself or in collaboration with other authors are examining small island economies in from regional perspective and his findings confirm those of Briguglio (McElroy, 2006; McElroy and Mitchell, 2011; McElroy and Medek, 2012). Works by other authors support this point of view (Lockhart, 1993; Easterly and Kraay, 2000; Pellinga and Uittob, 2001; Hampton and Christensen, 2002; Bertram, 2004; Read, 2004; Sinclair et al, 2004; Brown and Leeves, 2007; Prasada et al, 2007; van der Velde et al, 2007; Nunkooa and Ramkissoon, 2010; Jayaraman, 2011; Seetanah, 2011; Vella, 2011).

1.4 Institutions and economic development. Another part of theoretical framework is related to the quality of institutions, which is important in case of Crimea where new Russian government literally transferred Ukrainian administration and put few Moscow-related supervisors to oversee the process. Hence, the important question is that whether the ongoing development is qualitatively different from what was happening in Crimea before annexation.

Acemoglu and Johnson in their famous work «Why nations fail» (2013) study the way how institutions determine the level of economic development. Their approach is very close to what we are seeking to do in this research – they compare bordering regions (for example, US and Mexican parts of the same Nogales region) and point out to the differences that have made their levels of economic development to differ so much. In short, Acemoglu and Johnson argue that more effective and responsible state, accountable before population can become a driver of economic growth, if it will build inclusive political and economic institutions. This is a strong argument, which is supported by other researchers (Putterman, 2013). Though Russia and Ukraine were parts of the same country 25 years later, but as we will see later, Russia became relatively more developed than Ukraine in that respect. This fact might have affected economic

development of Crimea inside independent Ukraine. The studies of the economic effect of institutions in other countries support these findings: comparison of performance between states of India with different historical background (Iyer, 2010), CEE regions of former Habsburg empire (Becker and Woessmann, 2011) and between former British and French parts of now independent and united Cameroon (Lee and Schultz, 2012) confirm that historically conditioned institutional differences may be felt between neighboring regions inside one country or on the transnational scale.

We should keep in mind that the gap in institutional quality between Russia and Ukraine is not high enough, and the differences in the development of neighboring regions were also the result of Russia's much bigger internal market and overall higher levels of economic development in comparison to Ukraine. However, we have paid attention to this part of institutional studies. It is proved that in the long-term perspective better political institutions are decisive for economic development (Flachaire et al., 2014). The problem of corruption is strong, but as de Vaal and Ebben (2011) have pointed out, the corruption itself should be seen as the factor interacting with other factors – thus, not being fully damaging for economic growth, as long as some other institutions are working. Wedeman's classification of corruption regimes into «looters», «rent-scrappers» and «dividend-collectors» (1997) was also helpful in this respect as the way to distinguish between the most and least damaging types of political corruption. In case of Russia as a more rich country we could find use of the argument made by Law, Lim and Ismail (2013) that in low income countries economic gains foster better institutions. Taking into account that we will analyze performance in the territory which have went through the long period of stagnation and recession, we can't neglect Rodríguez-Pose argument (2013) that «institutional factors» (such as infrastructure, skills etc.) may be even more challenging as an obstacle on the way of economic development. This point of view is supported by Siddiqui and Ahmed (2013) who has found that for the developing economies solving the immediate institutional economic problems may be even more important than establishing the risk-limiting institutions such as

independent judges and effective regulation. This is consistent with our summary of Russian regional development programs and the approach that is apparently used by Russian government in the process of integrating and developing Crimea – first, narrowing the gap between it and more developed regions from the Russian mainland.

As the part of explanation why Crimea lagged behind the rest of Ukraine and suffered from stagnation and recession for the better part of its post-1991 history we use the suggestion that delayed privatization in the region could be of the components of the problem. In order to support this point of view we searched through extensive literature on the privatization effects in Central and Eastern Europe (CEE) and Commonwealth of Independent States (CIS). Most of the authors agree (Aghion and Blanchard, 1998; Megginson and Netter, 2001; Djankov and Murrell, 2002; Andreff, 2006; Brown et al., 2006; Estrin et al., 2009; Mickiewicz, 2010; Driffield et al., 2013) that privatization had a positive effect on the performance and efficiency of the enterprises involved – this effect was found in the neighboring Ukrainian regions and was absent in Crimea, where privatization was largely delayed until the early 2000s. Delayed privatization might have been one of the reasons of why economy of peninsula during 1990s shrunk and productivity of enterprises fell.

To understand complexities of Crimea's later development inside Russia it will be justified to address the more particular institutional questions crucial for economic development. Most of the researchers working in that area agree that the principal thing for further economic development is the level of protection of property rights (Williamson, 2000; Dyck, 2001; Acemoglu and Robinson, 2005), which consists of 2 parts: guarantees from the expropriation of the assets by political actors and judicial-regulatory responsiveness to the issues of property owners. When the working institutions of that kind are absent they are being replaced with more informal institutions, that substitute the legitimate official ones (Olson, 2000) – and this category includes illegal groups, such as mafia (Varese, 2005). This is consistent with our observations that Crimea, as the territory with unrecognized status, will suffer of the following problems:

problems with the establishment of property rights and the ensuing problem with their protection; high level of informal and illicit relationships in the economy.

We are making the point that Crimea's quality of institutions was not exceptionally high before annexation and it did not improve after annexation because the very legal status of the region today puts all of its economic transactions in the shadowy area.

1.5 Russian experience in regional economic development. Integration and economic development of Crimea took the form of «catching up» with the rest of Russia due to peninsula's underdevelopment, hence it would be justified to summarize Russian experience in the area of regional development programs: by 2010 there were 108 programs of economic and social development in 65 regions of Russia (Pertsov, 2010, p. 192).

In Russia top 10 regions account for more than 50% of total GDP in basic prices, which forced the government to apply number of regional development programs to narrow the gap between the most developed and least developed regions (Farra et al., 2013, p. 2-15). In case of depressive republics of North Caucasus (Farra et. al., 2013, p. 15) it helped to increase GRP and living standards, though it did not help to build self-sufficient and sustainable local economies, which would be independent from the federal subsidies. The list of FDI-attractive regions have changed little – fossil-rich regions benefited from the spike in gas and oil prices while traditional centers like Moscow and Saint-Petersburg kept their positions (Ledyeva , 2009).

There are very few regional success stories in post-Soviet Russia – among them is Krasnodar Krai, which will be examined later, and Novgorod (Petro, 2001; 2006). The latter is an example of importance of institutional factor for the successful long-term economic development. The survey of business-governors relations in Russia (Sharafutdinova and Kisunko, 2014) shows that despite the fact that the decision-making in country remains centralized, economic development in the region relies heavily on the quality of local governance. In that respect local governing authorities have relative autonomy as long as they remain political loyal (Stavrakis et al., 1997; Stoner-Weiss, 1997; Kirkow, 1998) – that makes the economic development of the region

dependent on the economic qualification of the governing authority, which may turn out to be high enough or the opposite. The latter is arguably not the case in Kremlin's strategy of allocation of funds for the regional development.

Assessment of 10 years of regional development in Russia by the Russian expert Natalya Zubarevich (2009) shows that though the depressive regions have improved their situation thanks to federal development programs and generous subsidies, they did not become self-sufficient and are unable to provide themselves with the same level of financing of their needs. Despite all efforts of equalizing, the divergence between the most developed and least developed regions in Russia just grew with years (Lehmann and Silvagni, 2013). This leads us to conclusion that the primary goal of Kremlin is to keep the subsidized region on the lifeline, satisfying its optimum minimum level of subsistence in order to prevent the undesirable social clash. It is consistent with our findings in Crimea where Kremlin did nothing to improve governing institutions and build sustainable development agenda, but concentrated on the ensuring the population's access to the acceptable minimum of services, which would be enough to prevent the humanitarian catastrophe and bring the new region's economic standards a little bit closer to those of mainland Russia. It has distant similarity to the case of Eastern Germany, which after many years of subsidization and improvement of institutions remains economically dependent on the western regions. That allows us to conclude that under the existing system there will be severe economic mismatches in Crimea between the high investments from the federal center and the very low returns.

Review of sources. Search for resources on Crimea was complicated. Even in the years preceding information there was insufficient research activity in that area. But nevertheless certain credible sources could be found. First of all that would be resource BlackSeaNews, which is headed by Ukrainian economists Andrei Klimenko and Tatiana Guchakova. Their series of articles summarizing results of economic development of Crimea within Ukraine was invaluable (Guchakova and Klimenko, 2012, 1-5) for this research. The cited series of articles is based on

the number of researches, published by Ukrainian think-tank Razumkov Centre (2011). Later, after annexation, both experts took critical stance towards new authorities and were persecuted – that is an indirect confirmation of their unbiased position since data presented and analyzed by them was of huge importance for us. Where appropriate, official Crimean and Russian sources were used – such as Ministry of Economic Development of Republic of Crimea (MERRK, 2015-2016), State Statistics Committee of the Russian Federation, Ministry of Resorts and Tourism of Republic of Crimea (MKTRK, 2013). We have also extensively used the reports of Foundation for National Energy Safety (FNEB, 2015) and the Crimean expert group «Crimean Project» (CP 1-3, 2015), which were very useful as Russian side expert assessment of the situation. Concerns about biases of such sources are understandable; hence they were extensively used as source of data for period preceding annexation – in order to avoid possible controversy. However, Russian and Crimean sources in the period after annexation could be used with certain caution, because cross-checking with Ukrainian sources reveals that there are no huge distortions between two countries in assessment of economic development in Crimea – Ukrainian economic resources (such as Krymr, Liga Biznes-Inform, Free Crimea, VoxUkraine, Black Sea News, Insider) are not questioning numbers presented by Russian statistics bodies, but concentrate on the political and legal aspects of the problem, which are not in the focus of our research. However, mentioned sources were invaluable as the way to validate or counter data presented by Russian sources with empirical facts and alternative points of view.

Russian resources, of course, had to be verified through the process of cross-checking and combination of critical thinking and common sense. In other words, official data on the infrastructural investments could be proven or discarded after checking the claimed results in the Internet. Use of independent Russian editions with established credible reputation (Kommersant, Vedomosti, RBC, Gazeta.Ru, Slon.Ru) and Russian/Ukrainian outlets of recognized foreign medias (Forbes, BBC) was quite important, taking into account problems with the search for data – these sources were important as a way of tracking for information and verification of the scarce

data, presented by Russian authorities after occupation. When it was possible, information from Ukrainian statistics office (State Statistics Committee of the Ukraine, 2011-2016) was used for the relevant issues – but unfortunately no official Ukrainian institution decided to cover the developments in Crimea after March 2014 (e.g. to count losses of Crimea from switching to Russian jurisdiction) to the extent sufficient for using them more often. But that may also serve as an indication of Ukrainian subtle recognition of the claimed Crimea's economic development results, which, as we would see later, are far from being a model example. Besides, data and facts presented after annexation does not show developments radically different to what has been in the process under Ukraine. Russian news agencies (RIA Novosti, Regnum, Lenta, C-Inform) and other sources of such kind (such as «Argumenti i fakti» newspaper) were used only where they have presented pure factology without analytics or any kind of interpretation to escape possible biases.

For information about construction business and real estate were used works by Russian evaluating experts Nikolai and Iliia Pichuev, also the reports from the Ukrainian system of Real Estate Market Trading System 1.0 (REM Navigator, 2014-2015). Tourist sector was extensively covered and well-researched in Ukraine, in general, and in Crimea particularly in the years preceding annexation (Nikolaenko, 1998; Shevchuk, 2009; Jakovenko, 2011).

English language sources were used where available to support arguments from the main part of the research, which remains predominantly in Russian and Ukrainian. Number of credible editions was chosen for the references in cases when the proof supporting presented argument was available in English (Wall Street Journal, Financial Times, New York Times, The Economist, Foreign Policy, Foreign Affairs, Forbes, The Guardian, The Telegraph).

Chapter 2: Economic development of Crimea from 1991 to March 2014

This part of thesis will deal with the questions concerning economic development of Crimea in the period when it was the part of independent Ukraine and up to the de-facto end of Ukrainian sovereignty on the peninsula. In the process, comparison with analogous Russian region of

Krasnodar Krai will be made. This review will provide basis for understanding why later economic integration in Russia and subsequent economic development have taken form of catching up with the rest of Russia, when the region has to be heavily subsidized in order to narrow the gap the existing gap with the rest of Russia. Summary of economic development in the top Crimean industries (such as tourism and agriculture) will be given and, when necessary, comparison with the region of Krasnodar will be provided to allow seeing how Crimea performed in the regional economic retrospective. Example of Krasnodar Krai is relevant in our case because it is positioned in the same Black Sea region, has roughly the same structure of economy as Crimea and in the contrast to Crimea provides an insight in to how similar regions could develop differently in the two different countries. Such comparison will serve as additional evidence, supporting the hypothesis that Crimea is bound to catch-up development in the process of being integrated in Russian economy.

2.1 Macroeconomic governance. After 1991 Crimea retained features of small island economy, we have discussed earlier (Briguglio, 1995) – the most important would be over-dependency on the «mainland metropoly». Before 1991 the whole USSR was this metropoly, after 1991 its place was taken by Ukraine, which due to the reasons we will investigate later, was unable to replace only part of what USSR single market and economic system could offer – which explains the following degradation and stagnation.

As a small island economy, Crimea was unable to afford its minimum subsistence levels without help from mainland metropoly, though that metropoly was not the richest one. In 2013 public sector wages consumed 4.6 billion hryvnas, most of Crimean budget revenues (Djatlukovich, 2014), making region dependent on Ukraine in provision of social payments.

Ukrainian strategy of development of Crimea till 2020 (Razumkov Centre, 2011) included considerable investments, which by the moment of Russian annexation totaled more than \$1 billion (by January 2014 exchange rate) with the government of the region being able to invest only a quarter of this sum (Djatlukovich, 2014). In 2013 70% of Crimea's budget expenses were

paid from mainland (Butrin et al., 2014). Even Sevastopol, which is often thought to be the city over-dependent on the service of Russian navy and tourists, earned only 20% of what it needed to spend while the rest of Crimea had this indicator at 34% (Zanuda, 2014). It should be noted that economy of Sevastopol did not enjoy large direct benefits from the presence of Russian naval base. Russia did not pay for its use of naval base in Crimea directly (Lukinova, 2013) – though, it ought to pay \$800 million to \$1 billion annually for lease of Ukrainian territory: starting from 1993 Russia was using debt amortization schemes from energy industry, thus paying only \$98 million a year (Ibid). «Intercompany eliminations» of this sort led to the situation when Sevastopol, in words of former Ukrainian minister of defense Anatoliy Hrytsenko «did not see the real money, which could be invested for Crimea» (Ibid).

As Russia later, Ukrainian mainland tried to enhance Crimean economy with the use of development programs. In 1999-2004 free economic zones (FEZ) and territories of priority development (TOR) were created in 9 cities and districts of Crimea (Guchakova and Klimenko, 2012 - 3). Ukrainian government and experts nurtured impressive plans of the development of Crimea (Baturin, 2006) – among which was the creation marine transport-industrial complex «Donuzlav» and creation of new resort, which together accounted for \$17 billion. Ukrainian authorities have built fossils extraction industry on the peninsula – this is the reason why Crimea today is more or less self-sufficient in its gas supplies (Tjurin, 2014), quite unlike mainland Ukraine, which, by spring 2014, imported 165% of its domestic energy production (Eide and Rösler, 2014, p. 13). As a matter of fact, development of these resources in Black Sea region was the main part of Ukrainian ministry of energy's strategy of developing energy independence of Ukraine from Russia (Boyko, 2012). However, in the end, all of that brought little success because Ukraine was unable to channel significant resources to the development of Crimea, the issue that becomes evident when economy of the peninsula is compared to the neighboring economy of Krasnodar Krai, which remained under Russian jurisdiction after 1991.

In our analysis of Crimea's economy before and after 2014 the principal criteria of choice of analyzed sector was demonstrativeness – we needed to show the difference between «before» and «after». These are the following:

- 1) Sectors with huge contribution to regional GRP and, biggest effect – agriculture and manufacturing;
- 2) Sectors, that most vividly reflect the changes that took place after annexation– transportation, financial sector, construction and telecommunications;
- 3) Sector, that is most representative in the sense of economic situation in the region – that would be tourism, because of the huge net effect it has on other sectors, including those mentioned above (+trade and others).

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Agriculture	19	16,4	16,8	18,6	18,8	19,8	18,1	14,8	13	12,6	11,5	8,7	8,2	9,7
Manufacturing	19,9	18,7	16	18	19,9	19,8	14,2	13,2	13,7	14,4	16,1	15,2	15,6	14,4
Construction	6,2	4,3	3,8	3,9	6,6	4,9	5,4	5,4	5,5	6,1	5,6	6,5	7,9	5,6
Transportation and Communications	11,7	14,5	13,5	12,8	13	14,2	13,3	14,5	15,7	13,9	12,1	11,7	10,8	10,1

The share of separate types of economic activity in the gross value added in the Crimea, %.

Source: Guchakova and Klimenko – 2, 2012.

2.1 Tourism and recreational complex. Tourism and recreational industry never were the only engines of economic development of the peninsula. In 2001-2011 period (Guchakova and Klimenko, 2012 - 4) share of enterprises from that sector made up just 6-8% of budget revenues. However, this sector will receive special attention, because of the huge net effect it has. Agriculture, food industry, construction are partially also largely dependent on the tourist flow. From the sectorial structure of GRP, it is difficult to assess the impact of tourism on the economy, because money spent by the tourists is distributed among various sectors of the economy, such as transportation, healthcare, agricultural production and trade. All together they account for more than 50% of Crimean GRP, so the developments in tourism industry might serve as a developmental factor for other industries and some form of indicator of overall

economic situation on the peninsula. It is also worth noting that tourism employs 21% of the workforce on the peninsula through permanent and seasonal jobs as many locals are renting out their property to the visitors (FNEB, 2015, p. 55).

During 1990s the sector suffered huge contraction, from which it did not recover. If in 1988 the peninsula was visited by the record number of 8.3 million tourists (Jakovenko, 2011, p.144) – the closest number since then was 6 million people in reached in 2009 (Jakovenko, 2011, p.140). It was the biggest number since Ukraine became an independent state and is still not reached up to the date by Crimea in Russia. Yet, nominal increase did not generate significant revenue, which would boost local tourist economy.

Due to the effects, caused by dissolution of USSR, tourists from Ukraine during 1990s have gradually replaced tourists from other former Soviet republics, of which the biggest group of contributors consisted of tourists from Russian Soviet Federative Socialist Republic (RSFSR), which after 1991 transformed in Russian Federation. In 2009 Ukrainian tourists made up 74% of all tourists on the peninsula (Slepokurova, 2013), after some decrease by the end of 2013 they still made up from 66% (Ibid) down to 60% (Ratnikov and Volkova, 2014) of all tourists in Crimea – which in 2013 was about 5.9 million people (MKTRK, 2013, p.1). Russians made up significant part of the overall tourist flow that year – 26.1% (Ibid, p.3), but they were far from being majority. This change affected the tourist industry significantly – in the course of 20 years after Ukraine gained independence, the average length of tourist stay in the Crimea decreased from 20-24 to 10-14 days, which reduced the loading of the resorts and hotels (Titov and Kuvshinova, 2014) and the period of holiday season decreased from 3.5 months in 1991 to 2.5-3 months in 2006-2009 period (Shevchuk, 2009, p.188). While increasing number of overall tourists, starting from the second half of 2000s, Crimea was losing the visitors with the highest paying capacity – only in the period of 2005-2009 the share of relatively rich tourists decreased from 50% of all visitors to 30% (Ibid). There is no precise data on the differences in expenditures of different nationalities in the last years of Crimea within Ukraine, but some

calculation could be made on the basis of tourist's arrivals in 2012 and 2014: in the first nine months of 2012 number of tourists was almost 6 million people who have spent on the peninsula 6 billion hryvnas (Markova, 2013), which at the currency rate of the time was something like 23 billion rubles; in the same period of 2014, when the inflow of tourists, according to different estimates, was between 1.35 million people and 2.361 million people (Bologov, 2014), 60 billion rubles were spent in Crimea (Ibid) – due to the fact of annexing Russians made up that year majority of the visitors. Of course this sum should be adjusted to inflation – but even after this correction it demonstrates the fact that purchasing power of Russian tourists in relation to Crimean tourism remained higher than of their Ukrainian counterparts.

This contraction had the long-lasting effects for the sector. Shortage of tourists was the reason why infrastructure in the region stagnated or degraded during 1990s. During Soviet period vacation in Crimea was largely subsidized in form of vouchers or by other means to make this type of vacation affordable to masses, which explains the proportions of representation of particular groups of population in tourist flow: 43% were from the ranks of the governmental office personnel and 36% were workers (Jakovenko, 2011, p. 144) – precisely the categories of population that were supposed to enjoy substantial benefits in socialist state. Collapse of the common state along with capitalist reforms have deprived these categories of population of their ability to afford vacation in Crimea, which partially explains the fall in number of visitors, discussed above, and explains why the filling rates of Crimean recreational centers in 1990's was, on average, at 45% of their capacity (Nikolaenko, 1998, p.54-57). Domestic market was too small to create demand sufficient to keep this industry afloat, while turbulent economic and political situation in Ukraine and Russia could not guarantee flow of tourists from outside. These views were shared by governing authorities of the region: Ukrainian Prime Minister of Crimea Anatolii Mohyliov in his interview concluded that after 20 year since the collapse of the Soviet Union, Crimea lost most of its potential in that sphere (Mohyliov, 2013). One of the most important consequences was the changing structure of Crimea as tourism and recreation center:

due to the decrease in number of tourists, their low purchasing power and decrease in a number of vacation days peninsula ceased to be predominantly all-the-year-round resort and became a seasonal resort, operating mostly during summer (Guchakova and Klimenko, 2012 - 4), which, in turn created a negative net effect, causing «similar seasonal processes in most sectors of the economy of the Crimea, in employment, in the fluctuations in level of the prices, the structure of incomes and consumer needs, in revenues of the budget, in the pressure on the social and engineering infrastructure» (Ibid). It also decreased competitive qualities of Crimea in the tourist sector, because beach season in the closest rival tourist economies like Turkey was much longer – from 6 to 7.5 months (Ibid).

By 2011 Crimean tourist infrastructure became inferior to almost all of its regional rivals, failing even to reconstruct the existing facilities, not speaking of massively opening new ones (Guchakova and Klimenko, 2012 – 5). That year from all 20 Crimean hotels, which were undergoing international certification, none has received 5-star rating (Ibid). Degradation of professional licensed vacation enterprises has created conditions for large shadowy economy, which made it difficult to get the budget revenues from the tourist sector and to count true number of tourist visitors.

In 2013 (Ministerstvo kurortov i turizma Respubliki Krym, 2013, p.1) only 20% of 6 million tourists were «organized tourists» (i.e. those, who went to hotels or other licensed recreation centers), the rest were visitors, who have chosen private accommodation. The problem was that this sector was not accountable to Ukrainian executive authorities, hence creating large opportunities for tax evasion. Now and then – net effect of the tourism contributed to shadow economy in the peninsula. For example, in 2008 99.8% of 8368 checked private enterprises, operating in food industry, gambling, fuel, alcohol and tobacco industries did not register their income, thus, hiding taxes (Regnum, 2008). In 2013 alone regional budget did not receive 2 billion hryvnas because of smuggling (Leshhenko, 2013) – more than 40% of budget revenues in 2013 (ZN.UA, 2014). This is the common problem of tourist regions around the world – for

example, in New Orleans online property renting platforms such as Airbnb attract many tourists to the non-taxable households, thus decreasing budget revenues from tourist industry (Walker, 2016).

2.2 Construction and real estate. In 2014 construction made 2.8% of Crimea's GRP and employed 3.7% of economically active population in the republic (MERRK, 2015, p. 55). Revival of tourist inflow in the end of 1990's made construction business for the purpose of tourism an attractive investment opportunity, yet at the cost of deteriorating ecological situation (Bokov et al., 1998). This sector, despite its relatively modest share in overall economic structure, was vulnerable to corruption and speculation. In 2008 Crimean GRP was about 27.4 billion hryvnas – approximately \$3.4 billion by 2008's exchange rate. It did not correspond to the price of land, because it was worth of only 1-1.5 thousand hectares of earth, meaning \$3-3.5 million for hectare (Guchakova and Klimenko, 2012 - 3). Profitability of luxury real estate construction far exceeded any other sector – 500% before 2008 (Ibid). Later, after annexation in 2014 real estate and land will be one of the fastest growing industries on the peninsula and one of the reasons for the intensification of the ethnic conflict between Russian population and repatriating Crimean Tatars.

2.3 Manufacturing. In the late Soviet times manufacturing made up almost 20% of Crimean economy, but even as economy shrunk in the aftermath of dissolution of USSR, the sector made more than 10% of economic output – something like 13.9% of regional GDP in 2014 (MERRK, 2015, p. 9). Shares of different segments is evenly distributed in the following way: production of food, drinks and tobacco – 27.7%; chemical industry – 16.1%; extractive industry – 10%; machine-building – 11%; supplies of electricity, gas, steam and conditioned air – 26.9% (Ibid, p. 11). At the moment of annexation, 9% of economically active population is employed in this sector (Kondratiev and Agibalov, 2014, p. 15).

Most of the enterprises have suffered from the downturn in 1990s that affected both Russia and Ukraine. This is not a unique story – most of Eastern European industrial enterprises have found

themselves in the same situation in 1990s as their hosting countries were unable to secure investments they needed (Berend, 1996, p.18) and were forced to sell valuable assets for low price to foreigners and closing down those, which were unable to compete with the production of much more developed foreign enterprises (Swain, 2011, pp. 1672-1677). The difference was that Crimea did not find any sources for recovery and subsequent growth.

Unlike in other transition economies, which after a period of economic and political turbulence in 1990s managed to achieve sustainable growth, economic restructuring in Crimea did not create the sustainable economy. «Labor force, dismissed from these industries, was absorbed mostly by small businesses, which in the Crimea was not to the great extent a classic type of entrepreneurship able to develop a middle class, but was the means of survival and self-employment of population» (Guchakova and Klimenko, 2012 - 2).

Light industry became virtually non-existent – and the rest was stagnating. For example, chemical industry increased its share in the peninsular economy significantly – but the output remained the same as in 1980s (Guchakova and Klimenko, 2012 - 3). Chemical industry in Ukraine overall was hit by 2008 economic crisis (Dymov, 2010), but big role in its decline and stagnation was played by ageing of equipment and technological lagging. In Crimea this industry remained afloat mostly thanks to the benefits of North-Crimean Special Economic Zone, which allowed the respective enterprises to meet their requirements in investment capital by returning some of the taxes (Guchakova and Klimenko, 2012 - 3). Another positive factor was that demand of mainland Ukraine for products like sulphuric acid did not decrease dramatically as surge in mining industry and metallurgy (where these materials are needed) on the mainland kept demand stable. Another factor was that the biggest enterprises in this sub-sector had natural monopoly in the production of certain chemical materials: «Krymsky Titan» is the largest manufacturer of titanium dioxide in Eastern Europe, «Krymskij sodovyj zavod» is the only Ukrainian manufacturer of technical soda ash, «Brom» factory is the biggest enterprise on post-Soviet space, which specializes on production of bromine and bromide compounds.

2.4 Agriculture. Crimea used to be one of the food industry centers in the Soviet Union, with specialization on the refinery of fish, fruits, vegetables and grapes (Guchakova and Klimenko, 2012). By 2013 food industry had a bigger share in the structure of regional economy than any other branch – even more than chemical manufacturing (Titov, 2014, pp. 8-13). At the same time production output did not increase – on the contrary, it fell as market and demand shrunk with the end of Soviet Union (FNEB, 2015, p. 11) and Crimean food industry became reoriented primarily towards internal market. All industries suffered major decline not only in 1990s, but also through the better part of 2000s (Guchakova and Klimenko, 2012 - 2) when economy of the mainland stabilized and enjoyed growth. Fivefold reduction of the area of the Crimean gardens and twofold reduction of vineyards (Ibid) reflected falling demand and the development of food and wine industries in the mainland Ukraine and elsewhere. Most of agriculture started to shift to private households – and not because they were more competitive, it was just another mean of survival for population (Ibid). However, decline in agriculture and food industry was not dictated by negative situation in Ukraine, but rather by lack of delay of privatization (Mironova and Shandra, 2002), that has prevented Crimean agricultural complex from adapting to the changing capitalist environment at the time when agricultural complex in the mainland went through these changes and was able to show positive growth by 2000s (Ibid). Decline was evident in all spheres of Crimean agriculture (MERRK, 2015, pp. 32-37), from the size of the acreage to the value of harvest.

2.5 Transportation. The region has relatively developed infrastructure (MERRK, 2015, p. 47): 14582.26 km of roads; 4 commercial sea ports (Kerch, Feodosia, Yalta, Yevpatoria); 2 ferry crossings; 2 civil airports (in the cities of Simferopol and Kerch); the developed network of railway lines with the length of 645.3 km. But even with this advantage, transportation rates in the region fell dramatically after the collapse of USSR – from 1990 to 2009 tonnage turnover decreased 2.5 times (Guchakova and Klimenko, 2012 - 3), reflecting shrinking importance of Crimea as the transportation hub on the post-Soviet space, which was inevitable, because Odessa

suitable transportation needs of Ukraine more and Russia was developing Novorossiysk at the time. In such surrounding, when Crimea ceased to be local hub of the bigger country, its transportation sector started to shrink along with many other sectors of economy.

2.6 Banking and finances. By February 2014 Crimea had around 180 banks with 1000 local branches with deposits of population up to 20 billion hryvnas (Krasnova and Verzhbickij, 2014). But in terms of lending activity Crimea was one of the least active regions, as overall economic situation in the region did not provide any incentives to sector for active expansion – lending to private households and businesses remained low as regional economy was shrinking or stagnating (Ovchinnikova and Ovchinnikova, 2015, p. 2). Almost 80% of all banking operations on the peninsula were carried out by 17 banks (Ovchinnikova, 2015, p. 21) and 30% of all deposits were stored in «Privat Bank» (Ibid). Within financial framework of bigger Ukraine Crimea did not have significant share: by February 1st 2014 collective debt of 350 thousand Crimean citizens was estimated as 16.6 billion hryvnas (Bocharova, 2015) – fracture of overall credit portfolio of Ukrainian banks, which soon reached almost 1 trillion hryvnas (Ormocadze, 2014). Nevertheless, the financial sector was working at its full capacity, had large number of banks represented and all international payment systems were functioning.

Moreover, financial sector in the region, at least in number of banks, was more or less at the development of more economically successful regions of Russia and Ukraine. It could be considered as one of the few sectors that went through positive change after 1990s. However, the latter could be attributed to the fact of transitional change from planned economy to market, when emergence of private financial institutions became inevitable.

2.7 Telecommunications. In the years preceding annexation this sector had high rates of development – for example, in 2013, which was depressive for Ukrainian economy, the regional growth in this area was more than 15% and the overall size of the market was estimated to be worth \$0,4 billion (CP, 2015 – 2, p. 25). 73% of revenues came from mobile communications, 11% from broadband wired Internet access, 8% for paid TV, 7% for fixed telephony and 1% for

broadband wireless access (Ibid., p. 26). Most of the mobile telephony was 2G, 3G was relatively rare. The penetration rate of mobile communication was lower than in Russia, 130% against 200% (Ibid.).

Mobile communications market was divided between 3 different companies: 57% – MTS Ukraine (MTS, Russia), 21% - Kyeuistar (VimpelCom Ltd, Netherlands), 16% - Life (55% belonging to Turkcell, Turkey; 45% to the group of companies under control of Ukrainian oligarch Rinat Akhmetov). Telephone density was about 59% for Crimea and 72% for Sevastopol – and over 72% of phones were serviced by Ukrainian company «Ukrtelecom» (Ibid.).

Overall, the sector was relatively well developed and though its state was far from the most advanced regions in Russia and Ukraine, it was corresponding to the overall development level of the region.

Summary. In the period from 1991 to 2013 Crimean economy largely shrank or stagnated in all sectors, except for banking, telecommunications and construction. Growth in first two was due to the fact that they were absent before the transition to market economy took place, the growth in construction owed to speculative factors.

The comparison with the neighboring Russian region would help to understand that different trajectory of development was not impossible.

Krasnodar Krai: different parallel development

Russian region of Kuban is different from Crimea in aspect of size and number of residents – its territory and population are roughly 3 times bigger than Crimea. At the same time, both regions share similarities, which make their comparison relevant and justified from scientific point of view: the density of population, sectorial proportions of agriculture and tourism, climate, territorial specialization and even urbanization rate –in Krasnodar Krai it is about 53% (Russian Federal State Statistics Service, 2015), slightly lower than Crimea's 58% (Ibid).

Unlike its neighbor, Krasnodar started to develop as a resort area rather late. Booming development of Crimea and environmental difficulties related to nature of Kuban region (Sochi had to undergo through terra-forming and reconstruction because it was a wetland, infested with malarial mosquitoes) made Sochi less attractive. Development of Sochi started just in 1930s (Conterio, 2015; 2016), when Crimea already was well-known resort with large centers of industry. During Soviet years Sochi emerged as the regional recreational center as well as agricultural hub, but yet it was second to Crimea and in the best years serviced up to 4 million people a year (Lappo, 2008). Just like Crimea in 1990s, Krasnodar Krai suffered from financial troubles and sharp decline in a number of visitors (Ibid). But unlike Crimea, even in the worst years the region was still able to attract investments in its infrastructure, which included number of five-star hotels, additional branches of the road and the train station (Ibid).

Krasnodar Krai is also an example of importance of the qualified governance for the successful economic development. In 2001 Alexander Tkachev became governor of the region and undertook number of measures, which included organization of investment forums and setting up the program «Resorts of Krasnodar Krai», thanks to which number of tourists increased from 5 million people in 2002 to 12 million people in 2009 (MK, 2014). In the meantime other sectors increased their output and productivity thanks to the similar stimulating policies. In the structure of GRP of the region the share of each of the five main sectors – agriculture, industry, transport, trade and construction – ranges from 10% to 20% (ITE, 2013, p. 2). Overall, Krasnodar Krai presents rare success story of the Russian regional development programs, which usually fail to deliver significant development, limiting down to keeping the chosen region on the optimum minimum subsistence wage. Natural results, as well as favorable conditions of being part of the big Russian economy (like having large domestic market and enough land and population), played the most important role, but regional economy received additional boost by Kremlin's politicized sports event.

In 2013 Krasnodar, prior to Olympic Games in Sochi, 11.6 million tourists have visited the resorts of region (Solovieva, 2014). But massive projects like Olympic Games helped to increase number of tourists in 2014 to 12.3 million people (RIA Novosti, 2015). The very fact of Russia being rich enough to host Olympics allowed Krasnodar Krai to benefit from these investments – private investments made up only 4% of \$45 billion of overall investments in Olympics (FBK, 2014, p.7), while the rest was done through state-owned companies. This investment looks even more impressive on the background of Sochi being relatively marginal region inside Russia (A.O., 2014), where such massive investments simply could not pay off – at least not as quick as they did in Beijing, where 75% of all Olympic investments were made for long-term infrastructure projects in the city of 20 million people (Lu, 2014). And yet, despite controversies surrounding Olympic Games that were a big achievement for the Russian Black Sea region, where «potential capacity for holiday accommodation» in 2009 was estimated at the level of only 600 thousand people per year (Shevchuk, 2009, p.188).

Like in Crimea, share of food industry increased in the economy of region, but unlike Crimea it did not lock itself in internal market, but became top exporter of food in other regions (PWC, 2013, p. 18). From 2002 to 2012 GRP of Krasnodar Krai doubled in real terms (Bljahman, 2014, p. 10) and region was among leaders in Russian rankings of the development of transport, engineering and social infrastructure (Ibid, p. 17).

In 2000s region has achieved high manufacturing growth index (Sugaipova and Zelepuhina, 2014, p. 165) – output increased 4.5 times in the first decade of the century. It is worth noting that in the process, brand new large plants were introduced (like German-Russian manufacturing plant CLAAS or heavy engineering plant in Armavir), while in Crimea no big new manufacturing plants were opened – the youngest enterprise is «Camozzi-pneumatic-Simferopol», which was opened in 1991, while Mikhail Gorbachev was the president of still united USSR.

In 2013 GRP per capita in Krasnodar Krai was 300 thousand rubles (State Statistics Committee of the Ukraine, 2013), while in Crimea it was about 93 thousand rubles (State Statistics Committee of the Ukraine, 2016). Why the two similar regions were developing different way? The differences between Ukrainian Crimea and Russian Krasnodar will be explained in the following part of dissertation.

Crimea and Krasnodar: explaining the difference

There are 3 aspects, which dictated lags in Crimean economy – first was economic, second related to the institutional developments in mainland Ukraine and the third will be political economy of market transition in Crimea itself.

First of all, the size and state of the economy. Russia had a bigger population, more natural resources and bigger share in global trade – that is why Krasnodar Krai, which was lagging in its development in comparison to Crimean in the beginning of 1990s, succeeded at replacing Crimea on the Russian market. Ukraine was simply incapable of providing Crimea with the same incentives and investments as Kremlin and Krasnodar leadership were able to. According to World Economic Forum experts, which comprised Global Competitiveness Index (Schwab and Sala-i-Martin, 2013), Russia scored much higher than Ukraine in terms of macroeconomic stability, quality of infrastructure, size of internal market and innovative potential. In some positions like professional training or the size of financial market Ukraine has surpassed Russia, but the gap in these categories is not really big and in rating summary Russia has position 64, while Ukraine has position 84 (Ibid). The fact that in 2013 GDP per capita in Russia was \$14818, big enough when compared to Ukraine's \$3919 (data drawn from IMF, 2014) explains why neither Ukrainian tourists, nor Ukrainian government had any funds to modernize Crimean economy and integrate it more with the Ukrainian mainland – instead, prior to Maidan almost half of Ukrainian working migrants were working in Russia (Neprjahina, 2013). Ukraine was and remains country, which is significantly poorer than Russia. In Credit Suisse's 2013 report Ukraine was noted among the poorest countries in Europe (Keating et al, 2013, p. 8). Economic

troubles in mainland Ukraine were immediately reflected on the peninsula in 2013: back then stagnation and looming recession in the Ukrainian mainland were evident (Panchenko, 2014) and rating agency «Standard & Poor» decreased rating of the region to the national level (UNIAN, 2013) – a worrying trend, given that Crimea did not enjoy the same gains of economic growth in the better period of 2000s.

Second explanation might be less obvious, but it could have played its role – the quality of institutions. That factor is argued by some scholars (Acemoglu and Robinson, 2013) to be of crucial importance for the economic prosperity. That might be part of explanation since there has to be the reason why Ukraine have started in 1991 with better economic situation than Poland and finishing in 2012 with real GDP lower than in the beginning and a third of what Polish economy could show (Hanke, 2014). In 2012 experts from PricewaterhouseCooper and World Bank (PWC and World Bank, 2012) have rated Ukrainian tax system as one of the worst in the world with only Congo and Venezuela behind. In the Global Competitiveness Index, cited earlier, Russia scored higher than Ukraine in terms of quality of the institutions (Schwab and Sala-i-Martin, 2013) – it has place 121, Ukraine is on the 137th place. Of course, this difference is not sufficient enough to explain why Krasnodar developed and Crimea stagnated, but this notion is worth consideration. Initial economic starting point was good – 6th largest consumer market in Europe, young and qualified workforce, access to growing markets of Middle East through Black Sea ports and the availability of cheap Russian gas (Eide and Rösler, 2014, p. 5). But «those in power focused on dividing the pie of the Ukrainian economy rather than growing it» (Ibid), which have cause stagnation and economic crisis in Ukraine which made Crimean population reluctant about joining with the rest of the mainland. In the research covering positive influence of Habsburg-era institutions on the development of the territories in modern states in Eastern Europe, which once belonged to Austro-Hungary (Becker and Woessmann, 2011) Ukrainian regions with Habsburg past (like Lemberg-Lviv) have much worse results than their counterparts in Poland. Corruption cannot be fully blamed for the economic underdevelopment,

as there are different types of it, some of which could not hurt economic performance (Wedeman, 1997) – an example of such approach could be Syngman Rhee’s South Korea (Ibid, pp. 465-469), where government supported business groups, willing to finance them and in the course of 3 decades economy increased 6 times. However, by Ukrainian standards of governance, institutions in Crimea were considered to be very good: in 2013 rating of effectiveness of governors, region as the whole (Sevastopol + Crimea) was second only to Kiev (Regnum, 2013). These results are partly the reason why quality of institutions is not the most important criteria – the worst results in this rating were shown by a couple of far western regions of the country (Ibid), which later did not show any inclination for secession. Yet, even in 2008, according to Ukrainian polls overwhelming majority of Crimean residents were in favor of secession from Ukraine and joining Russia, while maintaining huge resentment towards governmental and legislative institutions existing in mainland Ukraine (Ibid) – it is possible that the mentioned resentment existed also due to the part that corruption in the country may have altered economic development of Crimea as it did hurt economic development of the mainland Ukraine. This is not to say that Russia had less problems with corruption, but its abundance of resources and much bigger size of economy in comparison to Ukraine allowed Kremlin to build «rent-scraping» type of economy, example of which was provided by Philippines during rule of Ferdinand Marcos: elite group and people affiliated with it benefit from the exploitation of economy in the ways that benefit them personally, while overall economy continues to grow despite their otherwise hurtful actions, because of its size and potential (Wedeman, 1997, pp. 469-473). While suffering from the same problems as its bigger neighbor, Ukrainian economy was just not big enough to provide Crimea with incentives for the healthy growth.

Third explanation is that privatization in Crimea took place much later than in Krasnodar Krai and the rest of Ukraine – in the beginning of 2000s (Mironova and Shandra, 2002), when both Russia and Ukraine have established functioning free market. There are strong arguments against policy of shock therapy (Murrell, 1993), however, during 1990s Crimean economy continued to

work the same way, as it did in USSR, without any restructuring at all. Despite political gains (peninsula did not suffer social upheaval, which often comes with privatization), in economic terms this strategy just delayed the inevitable and increased the negative impact. Other regions of Ukrainian south (Kherson, Cherkasy, Nikolaev, Odessa) went through privatization already in 1990's and by the beginning of the new century there were functioning capitalist enterprises. Particularly in Crimean agriculture fall owed mostly to the rise of large and effective enterprises on the Ukrainian mainland. Presence of government of autonomous republic in local economy was always big and in 2004 it even temporarily took direct control over prices for gasoline, diesel fuel and some types of food products (Vesti, 2004). It is worth noting that in period of 1996 to 2010 share of Crimea in Ukraine's FDI statistics was decreasing (Guchakova and Klimenko, 2012 - 3). Announcement of Chinese investors planning to build deep-water port in Crimea and invest about \$10 billion in the peninsula (Hornby, 2013) seemed to counter negative trend, but these plans, first, were aiming for long-term perspective, and, second, failed to materialize altogether because 3 months later Russia have annexed peninsula and the lack of international recognition made perspectives of making business in region risky because of sanctions. But another signed deal of the period, agreement to lease some of Ukrainian arable land to Chinese holding to grow food for Chinese consumers, which was worth \$2.6 billion, included the region of Dnepropetrovsk (Zuo, 2013), but not Crimea – an indirect confirmation of relatively low attractiveness of region's agricultural sector in comparison to the regions in the mainland, which developed during 1990's privatization.

Summary. We can make the following conclusions, which are important for studying of Crimean economy after 2014:

- 1) After 1991 Crimean economy shrunk and suffered decline in comparison to its neighbors in mainland Ukraine and Russia;

- 2) The reasons for economic decline were primarily geo-economical: Ukraine was unable to offer Crimea the same economic opportunities which Russia could have offered to Krasnodar Krai;
- 3) Crimea retained the most important features of small island economies, most importantly – dependency on mainland, though the mainland have changed from Russia/RSFSR to Ukraine;
- 4) Economic development of Crimea is dependent on ability of mainland to invest in its development as the region is not self-sufficient in that sense;
- 5) By the moment of annexation Crimea was underdeveloped in comparison to its Russian neighbors – hence further integration and development had to take the form of regional development programme.

Our findings in this chapter are consistent with parts of our theoretical framework in the following areas:

- Small island economies: Briguglio and McElroy have pointed out that such economies are dependent on the mainland in economic sense (for investment, supplies etc.) even if they are not politically subordinate to this mainland. Other researches from the similar economies by other researchers confirmed it. Crimea has primary features of such economies – first by being dependent on the demand and investments from USSR, then from Ukraine. Worsening of situation on the mainland was reflected in Crimean economy – just like it happens with economies of this kind;
- Institutions: Acemoglu's works written in cooperation with Johnson (2005) and Robinson (2013) are stressing the importance of the institutional quality for the successful economic development; evidences gathered by different researchers in different regions (Iyer, 2010; Becker and Woessmann, 2011; Lee and Schultz, 2012) add to that notion that institutions may vary both within one country consisting of regions with diverse historical backgrounds or, on the contrary, be similar between different countries with the

shared historical past. It is relevant in our case, where Crimea was the part of one common country, then became the part of a smaller country with the worse economic indicators and lower quality of institutions. Another point is that we have examined negative effect of the delayed privatization on the Crimean enterprises – which supports the notion that privatization has generally positive effect on the performance of the enterprises;

- Economic integration: evidences we have gathered from the case of integration of former GDR allow to see and examine two neighboring comparable regions, that have different levels of economic development – in our case example of more developed territory was Krasnodar Krai, which have shown benefits of developing inside Russia (earlier and successful privatization; better institutions; the access to bigger Russian market).

Analysis of later economic development of Crimea in Chapter 3 will be based on these conclusions, as well as on the findings in the theoretical framework, which were provided earlier.

Chapter 3: Changes in Crimean economy after March 2014

3. Economic status of Crimea after March 2014. After the first year of annexation Russian administration have concluded the first stage of integrating Crimean in Russian political and economic system by taking the following steps (CP (2015 – 2, pp. 13-15): organizing elections and establishing governing authorities on the basis of Russian legal framework; creating development programs and development clusters for all sectors of economy; applying Federal Special Purpose Program «The Social and Economic Development of the Republic of Crimea and the city of Sevastopol till 2020» worth hundreds of billions of rubles; handing out Russian passports to population and reregistering the enterprises and other legal entities; recertification of military personnel, public officials and lawyers; implementing Russian legal framework; assigning donor regions from the ranks of successful Russian mainland regions to assist the new Crimean regions (for example, Moscow was chief donator to Sevastopol); creating SEZ on the territory of Sevastopol; introducing Russian ruble as the main currency.

It is important to mention that Russian central authority did not change governing structure of the region, by giving to the already present Crimean public officials and judiciary preferential right to join the ranks after annexation (FKZ №6, 2014). It means that despite the change in the upper governing authority to the Moscow-appointed governor, the rest of the governance remained the same because the people remained the same.

Ukraine also has taken steps in relation to the economic positioning of the region. Apart from not recognizing the new status of Crimea with all the ensuing consequences such as blockade and blackouts, the government in Kiev applied certain legislative measures: regulatory ban on the banking activity in the annexed territory (NBU №260, 2014) and the law recognizing Crimeans as banking non-residents (NBU №699, 2014); recognition of Crimea as free economic zone (Law №163, Verkhovna Rada, 2014), which also acknowledges its territorial status de-facto, though not de-jure. The external factors inflicted on Crimean economy were handled by the mix of state authorities and non-governmental actors with the expressed interest in return of the peninsula to the Ukrainian jurisdiction. For example, railway communication with Crimea was halted by Kiev government in the end of 2014, but the transport blockade which started in September 2015 and aimed to curb active trade between Crimea and Ukraine, was not the work of Ukrainian governmental authorities, but of the NGO «The Mejlis of Crimean Tatar People» and their supporters. Power outages were practiced by Ukrainian government since 2014 because the war in Donbass increased pressure on the Ukrainian energy supply system and left no spare capacity to supply the annexed Crimea (CP, 2015 – 2, p. 37) – yet blackouts became much worse during «civil blockade», when non-state militants have bombed supply lines to the peninsula (Luhn, 2015), which has accounted for more than 2/3 of peninsula's energy supply, thus hurting economic activity in the region for the period of insufficient energy supply. Such combination of unfavorable legislation in the mainland Ukraine and the additional pressure resulting from the disputes around peninsula and on it (such as Crimean Tatar community issue) have caused serious implications for Crimean economy.

International sanctions have also played their role on two levels. First, they affected most of the sectors, from banking industry to transportation by putting caps on the business activity that depends on foreign economic relationships of the peninsula – trade and FDI. By the moment of annexation Crimea had \$191 million in FDI – later most of the investors pulled out (Urkosta, 2015). Bypassing the sanctions proved to be possible, nevertheless sanctions had some success as they have increased transaction costs for those, participating in economic life of the peninsula. Second, they have scared off major Russian companies from participating directly in the region's economic development – the most clearly it is evident in banking and telecommunications. Even when investors come they tend to cover their presence through the use of fake shell companies or the simple non-disclosure of the investor's personality – the latter policy was applied in case of the future gambling zone on peninsula (Construction.Ru, 2016). That was the factor that continues to hamper economic integration of Crimea with Russia and its convergence with other Russian regions.

Factors, determining economic development of Crimea could be divided in two groups – transitional and inherited. Those, in their own turn, could be positive and negative.

Positive transitional factors are the following:

- Investment programs offered by Russian government: Federal Targeted Programme for Crimea and Sevastopol's Socioeconomic Development through to 2020, with financing totaling 708 billion rubles (JRL, 2016);
- Direct and indirect incentives and benefits, granted by federal center: most importantly Special Economic Zone, which was established for 25 years. Other incentives include indirect subsidies, such as refund of some cost of the ticket to the inhabitants of the mainland Russia, who choose to travel to Crimea;
- Closer integration with Russian market, which is bigger than Ukrainian one;
- Expected increase of demand from the military: Russia expands its military presence on the peninsula, creating armed forces group adequate to its status of one of the Russian

regions (Bogdanov, 2016). Possibility of spillover effect for the civil sectors of the economy is obvious, but it could also be that like in Soviet times presence of the military will spark demand for sophisticated products of military purpose from local producers.

Negative transitional factors would be:

- Questionable legal status of Crimea, affecting the economy directly (e.g. through sanctions and blockade) and indirectly (e.g. by creating uncertainty about property rights). Wide nationalization that took place in Crimea after annexation created problems with ownership rights. Ukraine has lost 27 enterprises that owned 42 thousand property units combined (Kulikov and Solomko, 2016) - 16 of them were listed for privatization. One of them, sanatorium «Foros», which earlier belonged to Ukrainian oligarch Igor Kolomoisky, was sold to the Federation of trade unions of the Republic of Tatarstan for 1,429 billion rubles (Ukrainian News, 2016), creating grounds for future legal disputes;
- Painful separation from Ukraine, while still being dependent in the supply of electricity and water from there;
- Ensuing closure of Ukrainian market (though not totally full);
- Transition to some of the Russian norms (e.g. in banking sphere) had a negative effect, because regulative pressure increased;
- Lack of the proper land connection to the mainland Russia. It is one of the major obstacles for successful integration and development of the region – it is expected that the bridge through Kerch Strait, worth 228.3 billion rubles, will be finished by the end of 2018 – and only since then the real growth could take place. The lags in connecting Crimea to Russia cause Russian government to postpone major investments on the peninsula (Sputnik, 2015; Moscow Times, 2015 – 2) because investing in roads and railway network does not make sense until the completion of

Kerch Strait Bridge, which will carry passengers and cargo from the mainland Russia to the peninsula.

Positive inherited factors:

- Diversified and relatively developed economy with huge potential in manufacturing, agriculture and tourism. As we have seen from the chapter 2, Crimea used to be an important economic hub in Soviet times.

Negative inherited factors:

- Major under-development in comparison to the regions in the mainland Russia and the ensuing need to ensure catching up of the peninsula with the national standards;
- Lack of proper connectedness with Russia (land connection by the bridge through Kerch is expected to start no earlier than in 2018) and disrupted connectivity to Ukraine increases the negative effects of the main feature of small island economy – dependency on the mainland (i.e. the expected benefits of the economic integration with bigger and richer Russia did not materialize to the scale that was expected because of natural infrastructural limitations);
- Problems with supplying energy. In energy supply structure Crimea is over-dependent on Ukraine (MERRK, 2015, p. 28) – Ukraine accounts for 70-90% of its energy supplies. Still after all hostilities, Russian government continues to pay for electricity supplies from the mainland Ukraine to Crimea – 13.2 billion rubles in 2016 alone, 800 million rubles more than a year before (Minenergo №1427, 2015). The way to secure Crimean energy independence by connecting it to Russian mainland energy system, is estimated to be about 47.3 billion rubles (Moscow Times, 2015 – 2) and it will take years to complete – no earlier than by the end of 2020 (Ibid.). Most of the water supplies also come from Ukrainian mainland – 86.7% before 2014 (MERRK, 2015, p. 57). In that respect sides did not come to mutual agreement and the water supply decreased dramatically, affecting dependent sectors such as agriculture;

- High criminality and corruption, as well as large share of informal economy, superseding even the Russian levels, did not disappear and continued to affect the economic development;
- Presence of non-complimentary Crimean Tatar minority serves as catalyst for disruptions (e.g. blackouts and trade blockade).

Findings from our theoretical framework are corresponding with these arguments and would be used in the process.

3.1 Macroeconomic governance. As was said earlier, Russia applies towards Crimea reconstruction policies and integration policies slightly similar to what FRG has applied towards territories of the former Eastern Germany – generous subsidization and financing in order to narrow the gap between the most developed and underdeveloped regions. The previously mentioned sum of 708 billion rubles intended for the development of Crimea does not include additional benefits and incentives, such as governmental subsidizing for the travels from the Russian mainland to the peninsula. Crimea’s features of small-island economy bring additional weight on the mainland, as Crimean economy cannot be sustained without the significant help from Russia. Kremlin’s task, however, is also complicated by the international status of Crimea, which brings such constraining factors as sanctions, disruptions in supplies, lack of clarity in property rights and many other related problems pointed out in the theoretical framework. Today Crimea is even more dependent on transfers from the mainland budget, while being internationally unrecognized part of Russia, than when it was part of Ukraine: around 80% of its budget consists of federal transfers (Sulejmanov, 2015). Given that value added tax stayed in Crimea in 2014, with all direct and indirect subsidizing schemes Crimea had 85% of budget coming from federal transfers – being in the same league as Chechnya and Ingushetia, subsidy-dependent southern regions of Russia (Ibid). Up to the moment Crimea remains one of the largest recipients of the federal subsidies (Volkova et al., 2016)

This is not the first time when Russia pours large sums of money in the unrecognized territorial entity: only from 2008-2013 Kremlin invested 34 billion rubles in South Ossetia and 19 billion in Abkhazia (Shkurenko, 2014) – both remain dependent on Russia as the main sponsor. South Ossetia budget depends on Russian transfers for 90%, Abkhazia is reliant for 40% (Ibid) and Kremlin is showing readiness to increase its financing of these break-away regions (Antonova and Himshiashvili, 2015). High level of dependency on the mainland was already typical trait of Crimean economy, but given the tense international situation fully independent economic development of the peninsula is highly unlikely – and that makes comparison with unrecognized republics of Southern Caucasus, as well as with other subsidy-dependent regions of Russia appropriate. External and constructional factors, accompanying economic development of disputed territories, as we will examine later, are slowing the economic progress.

According to estimates of Ukrainian and Russian officials, as well as independent experts (Kondratiev and Agibalov, 2014, p. 7) in the period of 2013-2020 Crimean economy would need 440 billion rubles of investments and subsidies – of which only slightly more than half would be investments, while the rest should be subsidies and social payments for population and socially sensible sectors such as electricity and water supply. The latter is understandable on the background of Crimean GRP per capita in 2013 (State Statistics Committee of the Ukraine, 2016) being more than 3 times less than in neighboring Krasnodar Krai (State Statistics Committee of the Russian Federation, 2013) – 93 thousand rubles against 300 thousand rubles. As we will see later, Russian government had somewhat of a mixed success – the economy shrunk or stagnated in most of the sectors, but there was no total collapse due to the increased subsidization of population and optimum minimum level of provision of all vital services. The first transitional year (Nikolaev, 2015) had seen 1.7 increase in the size of the salaries – up to 21692 rubles and by the end of 2015 it reached 30200 rubles (Volkova et al., 2016). That increase was overshadowed by inflation. GDP, by some accounts (Nikolaev, 2015) fell by 11%. In the researched period inflation was 80%, but partially that was the result of increase in wages

to the Russian mainland level and subsequent growth of prices also owed to this factor (Volkova et al., 2016).

Now we will see the changes that took place in the studied sectors after annexation.

3.2 Tourism and recreational complex. The data regarding tourist flow differs after 2014. According to official estimations, the peninsula was visited by more than 3 million people in 2014 (Lenta.Ru, 2015). Other estimations say that the inflow was about 4,1 million tourists (FNEB, 2015, p. 56) or 3.8 million people (MERRK, 2015, p. 43). The difficulty in estimating the true number lies in fact that was mentioned earlier – 80% of tourists settle in private sector (Ibid, p. 55) and the sector is barely accountable to the governing authorities, hence the true number of tourists is difficult to estimate as they often travel to the peninsula not as organized clients of recreational facilities, but as private visitors. It is still unclear how to count visitors, who came with tourist purposes, and separate them from people who have arrived to the peninsula for other needs. Yet it would be reasonable to say that the actual drop in number of tourists was no less than 2 million tourists, but no more than 3 million tourists – which would be rough equivalent of a number of Ukrainian tourists coming to peninsula every year before 2014. Such conclusions, due to the unavailability of the precise data, were drawn from the indirect signs, such as revenues from the tourism. Budget revenues from tourism, including the effects it had on other sectors, dropped by more than a third in 2014 – from 160 billion rubles year earlier to 103 billion rubles (FNEB, 2015, p. 56). Fall in a number of tourists was reflected in trade statistics, where turnover in retail decreased by 7.6% in 2014 (MERRK, 2015, p. 70). This data allows suggesting that there was a large drop in overall number of tourists, to a certain degree compensated by the growth in number of Russian tourists with their greater purchasing power. The factors influencing this sector are the following:

1) Inherited:

- Low quality of tourist infrastructure in comparison to other Russian regions such as Krasnodar Krai (Kondratiev and Agibalov, 2014, p. 10). Existing strategy of

attracting up to 10 million tourists annually requires, at minimum, 90 billion dollars of investments (Ibid). At the moment of annexation, level of attrition of the recreational facilities was ranging from 70% to 90% (FNEB, 2015, p. 56; MERRK, 2015, p. 45);

- Shadow economy – most of the tourists stay in the private households, thus complicating process of tax collection and statistical accounting.

2) External/transitional:

- Sharp drop in a number of tourists from Ukraine due to annexation;
- Emerged infrastructural problems. Most of the tourist flow had to switch to the other means of arrival to Crimea, as the land border with Ukraine became much harder to access because of the political problems. Switch from the train transportation to the cars and airplanes had to make an impact in tourist accessibility. By official Russian accounts, the accent on these methods of transportation will allow to move to the peninsula no more than 4 million people (MERRK, 2015, p. 44);
- Change from Ukrainian customers to Russian customers. In the first year alone demand for cheap vacation fell 2 times, while demand for «all inclusive» type of resort increased 4 times (Novosty Kryma, 2015). That confirms our earlier idea about greater purchasing power of Russian tourists in comparison to their Ukrainian counterparts. Expectations of Russian tourists were higher than what Crimea could have offered at the moment and that is partial explanation of why tourist inflows still haven't reached peak Ukrainian levels.

In 2015 Crimea was reported to have about 4.5 million tourists (Lenta.Ru, 2015 – 2; Deriabina, 2016) – the overall number may be argued, but it correlates very well with the decrease in the number of Russians travelling abroad (Moscow Times, 2015) – their number fell almost by a third, from 14.5 million tourists in 2014 to 10 million tourists in 2015 (Kottasova, 2015). The

geopolitical concerns may have played their role, but the most likely reason for that was sharp depreciation of the Russian currency over 2014/2015 period, when it started as the result of structural problems in Russian economy and the effect multiplied by the falling oil prices and sanctions (Gorodiloff, 2015). Russian resorts and vacation sites had to benefit in certain ways from this fall as they became more affordable (Tihonov, 2015) – and that is logical that if Crimea became part of Russia de-facto and already has an established reputation in that sector, there was some increase in a number of tourists. Though the number of tourists from Ukraine decreased dramatically, they still contribute something to the overall number of visitors. Governmental incentives, promised by the first persons in the state (Wojazer, 2015) came into force later that year – the subsidized travel packages and other measures have made this tourist destination more attractive (Abrams, 2015; CP, 2015 – 2, pp. 40-41). Other measures such as billions of rubles in federal financing for renovation of tourist infrastructure (CP, 2015, p. 16) also were of help. All growth in the tourist sector after March 2014 is the recovery growth and it is unclear whether peninsula would be able to meet post-Soviet maximum of more than 6 million visitors. There are few obstacles:

- 1) Lack of proper connectedness with the Russian mainland – in this respect, Krasnodar Krai is more attractive as it has much less problems with transportation. Traffic capacity of used transportation routes is reaching its limits and the controversial project of the bridge over Kerch is highly desirable in that sense;
- 2) Average Russian tourist is used to much higher standards of vacation and the region has to catch up with it. It might be linked with the connectedness issue – inflow of Russian tourists would make vacation providers to adjust for their tastes.

3.3 Construction and real estate. As it was observed in the part, related to the economic development of Crimea in years preceding annexation, this sector promised highest returns and profits, though due to speculative factors. Annexation brought no changes to this trend and, moreover, accelerated it: in the first year alone prices for real estate in the region rose 50% in

dollar terms (Pichuev, 2015 – 2) – the change even more spectacular, given the fact that during this period ruble has suffered major depreciation and if this fact will be taken into account, then the hike in prices would be about 150% (Ibid). The large part of the increase that year took place between March and June 2014 – confirming our preliminary conclusions that considerable share of growth on the peninsula happens on the promises of investments and reconstruction projects from the Russian mainland, reflecting its features of small island economy.

Other drivers of growth were of the same nature – among them was increased demand for Crimean properties from the wealthy citizens of Russian mainland. The tourist property construction boom intensified even in the unfavorable economic circumstances of complicated transition period (FNEB, 2015, pp. 60-62), guaranteeing growth to this sector in the time of recession and stagnation in other industries. Another driver, though on much smaller scale, was the federal program of renovation of housing estates (Ibid., pp. 62-65).

By February 2015 price per square meter have almost reached Moscow levels – 94 thousand rubles compared to 105 thousand rubles in capital (Dom. Lenta, 2015). Integration factors played their role as well – the lack of state registration of property rights (d'Amora, 2014; ROO, 2014, p.1) was causing lags in the development of the market, causing prices to increase on the speculative grounds, because most of the estate deals happened to be in dollars – so while deals were delayed in order to conduct them within Russian legal field, property prices increased along with the dollar price; other integration issue was that realty estate market in the region was formed with respect to Ukrainian pricing logic (Pichuev, 2014, p. 1-3), while simultaneous ascension to Russia resulted in rapid changes over the short period of time. In the issues of construction standards there were no transaction costs related to integration – seismic risk evaluation standards, for example, were the same in Ukraine and Russia, though both countries developed independently from each other for more than 20 years (Pichuev and Pichuev, 2014, pp. 1-4). Features of unrecognized territory had impact as well: new borders caused problems of logistical and transportation nature, inevitably increasing prices for the building materials –

supply route for new construction materials shifted from mainland Ukraine to Russian South which so far can be connected to Crimea only through ferry (Pichuev, 2015); entrenchment of the local economic elites was also evident – the list of biggest construction companies remained the same, all of them domestic (Pichuev, 2015 – 2) – no large companies from mainland Russia have intervened. Market of commercial property in Sevastopol has also increased, though at much slower rates (Pichuev and Pichuev, 2015).

In the second year after annexation negative factors started to have an effect: by the end of 2015 estate market prices contracted by 27% in dollar terms (REM Navigator, 2015). The most visible external factor is economic recession on the mainland Russia which resulted in GDP contraction around 3.7% (Zavyalova, 2015; FT, 2016; Luhn, 2016) – spillover of these problems to Crimea was inevitable because of its dependency on the mainland as the provider of investments and driver of demand growth. Status of unrecognized territory resulted in blackouts and civil trade blockade of peninsula from the Ukrainian mainland. This negative factor had to take effect, because pricing depends on the infrastructural issues (Malpezzi, 1999) – bulk of the demand concentrates in the segments of comfortable real estate equipped with all necessary facilities and infrastructure (Informer, 2016). These segments were the most vulnerable to disruptions caused by external influence. Positive development factors were almost absent on the market – the growth in the previous year was based upon expectations which had grounds in announcements of generous investment, but none of them was realized so far and no development announcements of the same scale were made that year. Another negative moment related to the legal stature of the region, was the lack of major banks – while Ukrainian banks withdrew from peninsula, no major Russian mortgage market players have entered Crimea, hence depriving real estate market of the growth incentives. Influence of sanctions appears to be limited – as principal «Crimean» sanctions were enacted in 2014 when the explosive growth has happened and this factor could have only indirect effect – by creating problems in the economy of mainland Russia.

Growth of prices contributed by integration and ensuing rise in demand from Russia could be attributed to the positive development factors and at the moment it appears that these factors have reached its limits, while negative factors (problems emerging from legal status) just started to take their effect. In future latter could force prices to plunge if Russia and Ukraine will engage in a military conflict over peninsula or the control over it will be restored by Kiev. The second option is justified because it is contrarian to market expectations of increasing demand from mainland Russia, that drove prices that high – the rise in supply by 62% last year combined with decreased demand (REM Navigator, 2015) indicates lack of confidence from potential buyers. Along with the fact that even after a year inside Russian most of the deals in the sector were nominated in dollars (Pichuev, 2015) it reflects lack of buyers' confidence. The issue of property rights remains solid – if the peninsula will become Ukrainian again there will be problem with the legal acknowledgement of deals and contracts signed during the period when peninsula was Russian.

But with or without it, negative or positive economic developments in the mainland Russia would be immediately reflected by the sector on the peninsula. So far influx of Russian buyers and tourists have stimulated development of this sector, though it had a setback a year later – in the mainland Russia real estate is also considered to be a reasonable investment, so more growth could be expected based on speculations regarding Kremlin's investment programs in the region. Among other factors and spillovers from these developments would be the intensification of ethnic conflict, which would be examined further.

3.3.1 Construction and the effect on the Crimean Tatar community. Reports on the discrimination of Crimean Tatars in the period following the annexation (Thoburn, 2015; OSCE, 2015, pp. 83-89; EP DROI, 2016), which included supposedly forced emigration of 10 000 Tatars from peninsula to Ukraine (Brisiuck, 2015) are not surprising on the background of this group's disapproval of the secession of Crimea from Ukraine (Kenarov, 2014). Crimean Tatar community did not change its stance on the subject after 2008 poll revealed that majority of

Crimean inhabitants would favor becoming part of Russia, while Tatar community was predominantly opposed to it (Razumkov Centre, 2008) and in the aftermath of annexation, according to polls, did not see any improvements in their life (Muhametshina, 2015), though their language was given official status on the peninsula soon after annexation. Official Russian experts have recognized Crimea as the region with the highest risk of ethnic tensions (CINK, 2014, pp. 7-9), contrasting with relatively low levels in other regions of Russia (Ibid, p. 2), due to the confrontation between Russian majority of peninsula and Tatar minority.

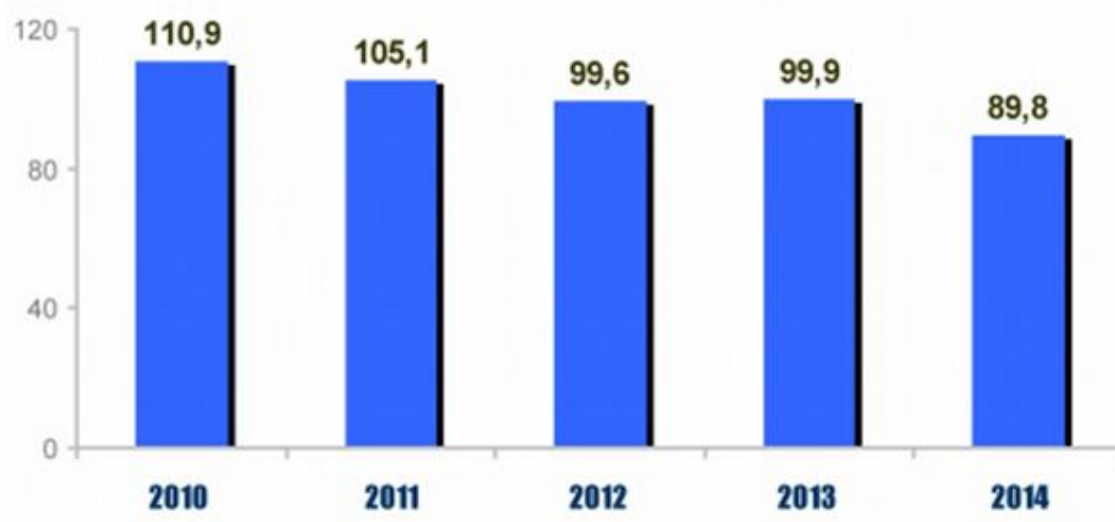
Most of the disputes revolve around the question of the redistribution of land (Okrest, 2015), which is the distant consequence of historical cataclysms: during WWII Crimean Tatars were deported after being accused of treason (Uehling, 2004, pp. 37-41) and lost their traditional lands and property. At the moment of rehabilitation and the subsequent repatriation of this ethnic group in 1980's which cost Ukraine \$300 million in reparations (Ibid, p. 42) satisfactory outcome became questionable as most of the land already belonged to other owners and it proved to be impossible to get land for resettlement by legal means (Ibid, pp.209-210). Because of that, repatriates started to seize the land and construct homes without permission (Ibid, pp. 211-230). Squatting and land grabs became the part of everyday economic reality by the turn of the century, as increasing number of repatriates started to obtain more and more land, which had questionable legal status (Kermenchikli, 2015). Land and the related construction business were the industries with the highest margin in 2000s (Guchakova and Klimenko, 2012 - 3) as wealthy Russians were investing in the land and real estate on the peninsula (Segodnya.UA, 2013) – in such circumstances scarcity of usable land, typical trait of many other island economies, had to provoke tensions with Crimean Tatars, who were the main obstacle for highly corruptive construction business even without political factor. Last Ukrainian Prime-Minister of Crimea Anatolii Mohyliov had a long history of conflicts with Crimean Tatars, all of which were somehow connected to the distribution and use of land (RIA Novosti, 2011; Livanov, 2011; Milli Firka, 2013), once even resorting to the extensive use of force, when Ukrainian special forces

were used to disperse and close down market, illegally organized by Crimean Tatars (News.Ru, 2007). It is questionable, of course, how intense pressure on Crimean Tatars would be if the peninsula remained the part of Ukraine, but overall direction of this conflict was the same, as Ukrainian elites were heavily involved in the land schemes and construction business – such as Ukrainian ex-minister of defense and former MP Parliament from the Bloc of Yulia Tymoshenko Pavel Lebedev, who has built large construction company «Parangon» in Crimea when the peninsula was the part of Ukraine (Bezramkov, 2015) and maintains his business activities already within Russian economic and legal framework (Nikiforov, 2015). At the moment, he is the vice-president of the Russian Union of Industrialists and Entrepreneurs.

Dynamics of land distribution remains regional matter, where local specifics determine further deterioration of the conflict more than federal policy: Russian president Vladimir Putin have signed law, which would allow Crimean Tatars to legalize their territorial possessions in the first months following the annexation and have announced repatriation and rehabilitation of this minority group as the part of bigger strategy of economic development of Crimea up to 2020 (Birjukova, 2014), most likely in attempt to gain community's trust – the policy Kremlin attempted to pursue in beginning (Luhn, 2014). However, by March 2015 12000 Crimean Tatars still lived on the seized land in illegally built housing – there was no change in their status (Shevchenko, 2015). New, Russian Prime Minister of Crimea Sergey Aksyonov insisted on the eviction of tenants and demolition of property, because regional legislation regarding legalization of seized land (which was passed half a year after Putin's decree) made it extremely difficult to legalize the land for its current tenants due to the complex rules and eligibility criteria for candidates, which de-facto excluded from the candidate list over 70% of the tenants (Ibid). Area covered by illegal housing is estimated to be around 1.4 thousand hectares (RIA Novosti, 2015 – 3) – and most of it is expected to be brought down by the authorities. Case of Crimean Tatars is basically similar to the cases of other minorities from the integration and disputed territories examples we have studied. Though Tatars were not a privileged minority group under

Ukraine, but like other minority groups from countries, that underwent transition (legal or illegal) – they were first to lose from the change of political environment.

3.4 Manufacturing. This sector has suffered moderate contraction. By the end of 2014 output decreased by 9.9% (MERRK, 2015, p. 10). Food manufacturing decreased by 20.7%. (MERRK, 2015, p. 16-18), though fall in this sub-sector was not equal: production of meat products increased significantly, while production of alcohol halved and fishing industry collapsed as this part of sub-sector have lost the Ukrainian market, which consumed 90% of its products (FNEB, 2015, p. 47-48). Chemical manufacturing decreased by 16.4% (MERRK, 2015, p. 20), machine-building decreased by 11.7% (FNEB, 2015, p. 50; MERRK, 2015, p. 23). Not all of the sub-sectors have shown bad performance in the first year after annexation: metallurgy and manufacturing of finished goods from metals grew by 27% (MERRK, 2015, p. 23).



The index of industrial production. Source Ministry of economic development of Republic of Crimea <http://minek.rk.gov.ru/>

The factors, influencing it can be categorized as external, transitional and inherited.

- 1) External factors – those, that were the result of actions of other actors and were out of hands of Crimean authorities:
 - Fall of demand from abroad and Ukraine – for example chemical industry was among the sectors most vulnerable to that change;

- Sanctions – one of the reasons of the fall in the trade and FDI. Players in different sectors have to invent complicated schemes for export and acquirement of the sought technologies and equipment or simply face the fall in exports and production (Kostiaev, 2015): in the first group we could find oil and gas company «Chernomorneftegaz» had to buy needed equipment from «Siemens» through the third parties; in the second group there are alcohol makers, who used to export their products abroad and suffered decline in their revenues;
- Increased energy costs – Crimean energy system can supply only 20-23% of energy needs on the peninsula, while being dependent on Ukraine (Kondratiev and Agibalov, 2014, pp. 28-31; MERRK, 2015, p. 28;). Since 2014 blackouts became the fact of everyday life (CP, 2015 – 2, p. 37; Olearchyk, 2015; RFE/RL, 2016). Russian authorities prevented full-scale humanitarian crisis by moving mobile gas turbine power plants and diesel generators to peninsula, but their primary task was to ensure the functioning of social and military infrastructure (hospitals, airfields, railways etc.), not the business-related activities. Crimea is expected to join Russian energy system no earlier than in 2017. It is worth noting that at this moment Russia has a number of other isolated energy systems behind Ural – which is understandable in the light of its large distances. Crimean officials estimated the size of the damage, inflicted by energy blockade, to be around 2 billion rubles (Construction.Ru, 2016 – 2). These estimations do not include losses Crimean enterprises have suffered from the inability to make their products and services in time; hence multiplication effect would be much greater. For example, installment and activation of diesel generators with the power of 750 MW alone costs \$10 thousand (Puzyrev, 2015), plus the costs of diesel oil and the work of the specialist. The blackout affected all other sectors, most visibly – trade and hospitality industry (Ibid.);

- The shortage of raw materials – some parts of the sector, most reliant on that (such as production of alcohol) suffered dramatic decline (MERRK, 2015, p. 17), while chemical industry needs water supplies from the Ukrainian mainland (FNEB, 2015, p. 41). The good example will be factory «Crimean Titan», owned by Ukrainian oligarch Dmytro Firtash's Group DF – it was receiving raw materials from Ukraine but was exporting its finished products to Russia.
- 2) Transitional – inflicted by shifting from Ukrainian economic and legal framework to Russian one:
- Changing to Russian legislation. All of the business working on the peninsula had to withdraw or register according to Russian legislation – and most of the enterprises did so (CP, 2015 – 3, p. 26). It is impossible to calculate expenditures enterprises had to face while allocating their time and resources for this process; however, it was still some «lightened» form of disruption from their everyday activities, as it brought additional paperwork and some uncertainty in their activities, which might have influenced their output. Before Russian annexation region had 54 thousand enterprises and 135 private entrepreneurs – in a year, their amount decreased 2,5 and 3,4 times respectively (Nikolaev, 2015). Large share of this was the result of nationalization or exodus of enterprises from Crimea, but some of this could be attributed to the challenges of attestation and re-registration.
 - State property ownership and nationalization – particularly in the part concerning property of the Ukrainian state (CP, 2015 – 3, pp. 19-21): railway, 141 agricultural enterprises, 109 recreational facilities and some objects of smaller importance. This process has contributed to the erosion of private property institutions, importance of which we have discussed in the beginning of thesis. It might have long-term consequences as entrepreneurs from Russian mainland would find it difficult to engage in the demanding projects on the peninsula

because of the risks of the arbitrary expropriation of their property – which could also happen if the ownership of the peninsula would shift back and Kiev government would refuse to recognize their property rights;

- Logistical switch – before 2014 most of Crimean exports went to the Ukrainian port of Odessa, but after annexation it needed to switch to Kerch, the move that brought additional transition costs;
- Inaccessibility of the financing – the number of banks shrunk, while the remaining ones are aiming more at servicing the basic needs of population, than loaning to farmers.

3) Inherited – traditional illnesses of the sector, which were present there before annexation:

- Need for modernization in order to gain greater competitive edge – the growth in manufacturing was already decreasing and almost came to a halt before annexation (MERRK, 2015, p. 10);
- Ensuing need in generated demand from the mainland;
- Low level of innovational activity;
- Insufficient number of qualified workforce.

In 2015 manufacturing grew by 35% - mostly due to increases in segments of the food production, extraction of valuable resources and electricity generation (KIA, 2015), Growth in these industries reflects overall crisis in the economy – disruptions in the supplies of food and electricity have increased demand for food products and energy supplies, from which local producers were bound to benefit. Growth in extractive industries was due to the development of the local oil and gas reserves, which are considerable: by 2013 peninsula was supplying itself with 82% of gas it needed, and the offshore oil reserves in the disputed Black Sea region were estimated to be about 435 million tons (Kondratiev and Agibalov, 2014, pp. 24). However, growth in this area was driven by blackouts and blockade – most of the produced gas is being consumed by the population, which needed it more often as ways for establishing gas supply

independent from Ukraine were sought (Ibid, p. 25). Yet, by the end of 2015 a tendency for the decrease of gas extraction emerged – 1.5 billion cubic meters were extracted in 2015, which is 0.15 billion cubic meters less than in 2014: the most obvious explanation is stress from blackouts, which increased demand for gas-generated electricity (Karamanoglu, 2016).

In future, the manufacturing on the peninsula will most likely re-orient to the Russian market due to the political incentives. Additional driver may be the expected surge in military contracts and shipbuilding in the near future.

3.5 Agriculture. This sector is divided between two roughly equal parts: cultivation of plants and growing of livestock. Half of the output is generated by population in small private farming households (MERRK, 2015, p. 31). In 2014 sector had mixed results – cattle raising contracted by 2.9%, crop production increased by 2.1% (FNEB, 2015, p. 52), but the gains and losses were distributed unequally across segments of the sector: for example, while production of grain and leguminous cultures decreased by 11.5%, production of milk contracted by 6.6% (Ibid., p. 53).

Factors influencing it:

- 1) Combination of legal and transitional factors resulted in the disruption of water supply and trade.
 - North Crimean Canal is crucial for the regional irrigation and supply of drinking water – as it can be seen from the **Map 1** Crimea remains dependent in this relation on Ukraine. The Canal used to supply peninsula with more than 80% of the water it needs (Hobson, 2014) and no equal substitute was found for the region after annexation. Partially that problem was solved by diverting the water from Biyuk Karasu river to Canal (RIA Novosti, 2015 – 4), but the insufficient amount of water for irrigation remains a problem and it couldn't leave the sector without any consequences. The problem is not being downplayed and was recognized by different official bodies such as he chairman of the Federal Committee for Water Economy and Melioration of

Crimea Igor Vail (Sobytiya.Info, 2014), Minister of Natural Resources and Environment of Russia Sergei Donskoi (APK Inform, 2015) and a chairman of Public environmental Council in Sevastopol Margarita Litvinenko (Krymr.ORG, 2016) – up to the date supplying of peninsula with water for drinking and irrigation comes from shifting resources from the one part of the region to another. In the first 1.5 years after annexation water consumption on the peninsula fell 5 times in comparison to 2013 levels (Crimea Inform, 2015). The most of projects related to the establishment of water supply safety on the peninsula will start no earlier than in 2017 (Crimea Inform, 2015 – 2), hence the problem is likely to persist, because all available local sources of water supply only 15-20% of the region's needs (Kondratiev and Agibalov, 2014, p. 35) This cannot be fully attributed to the simple logistical transition to Russia, because it was the international status of the region that led to the disruptions in water supply. For example, Singapore is also heavily dependent on Malaysia in its water supply (Zengkun, 2015), but since its secession was recognized by the mainland, it does not suffer from similar disruptions;

- Limited access of the Crimean agricultural producers to the Ukrainian market;

2) Inherited negative factors, that ensue from stagnation and degradation of 1991-2014 period:

- Inefficient use of irrigated land due to reduction in irrigation capacity. Though it was crucially important for the peninsula, Canal in 1990s has suffered contraction in its water supply capacity – by the 2014 it supplied peninsula with 1-1.2 billion cubic meters a year, which is almost 2 times lower than during Soviet peak times (Kondratiev and Agibalov, 2014, p. 36). It should be noted that this decrease was

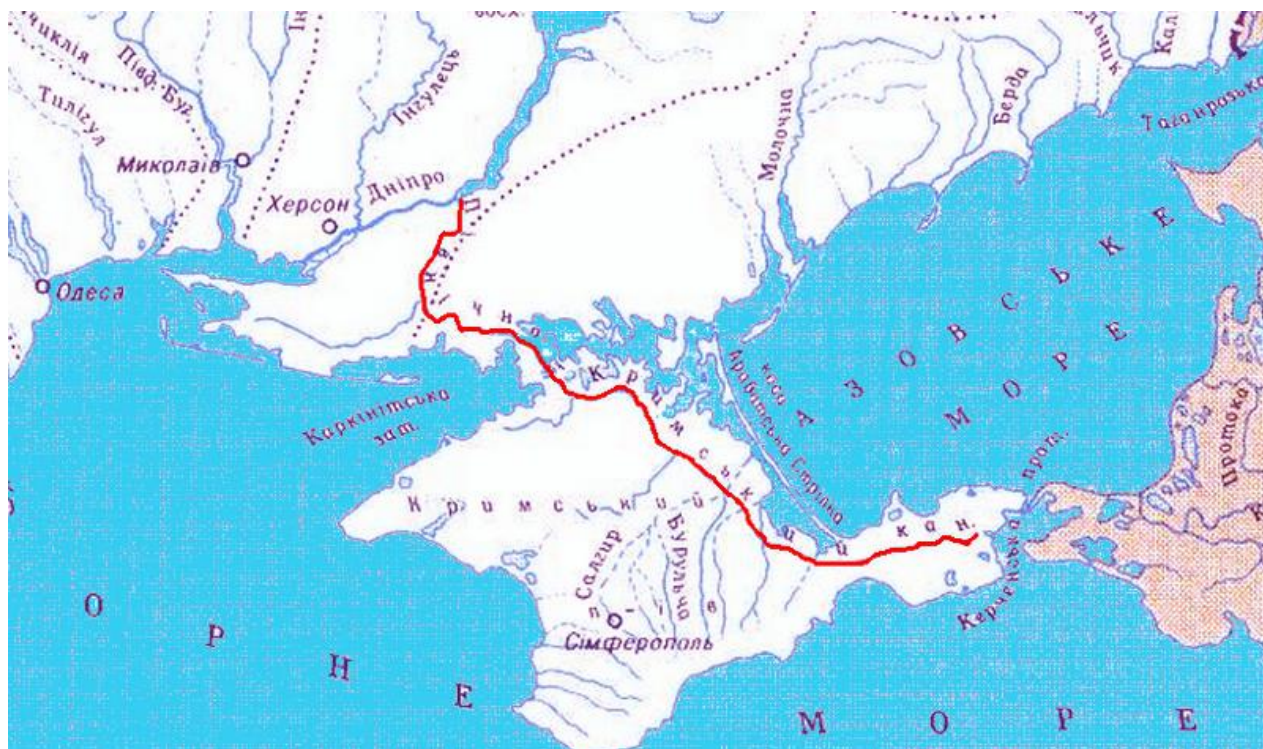
also influenced by the fall in a number of tourists, but as we have observed earlier, but agricultural sector also shrunk and the shortfalls in water supply became the factor that added to the transitional problems: reservoirs were not filled to the maximum and it decreased the ability of regional administration to soften the effect from the disruption of supply;

- Results of 20 years recessions and stagnation in agriculture. Reduction of acreage areas, reduced crop yields, decrease in harvest and food production had a negative effect: in 20 years after independence harvest of fruits decreased 4 times, harvest of grapes 3 times and grain cultures more than 2 times, while overall size of acreage decreased by 39.1% - from 1198.8 thousand hectares to 729.6 thousand hectares (Kondratiev and Agibalov, 2014, p. 12; MERRK, 2015, p. 31-37). This is a long-term trend and its consequences couldn't been reversed fast – especially not in the environment, burdened with a lot of external negative factors such as sanctions and disruption of water supply from Ukraine;
- Prevalence of small house holdings in the structure of the sector. They are based on the physical labor and cannot use the modern expensive machinery. The latter was quite important – according to Crimean Agriculture Minister Nikolai Poliushkin before annexation every year Crimea used 700 combine harvesters from the mainland Ukraine (Poliushkin, 2014) and their working power is missing after annexation;
- The low level of development in breeding and seed production – and resulting dependency on the import of the needed species and types from abroad or mainland Russia (FNEB, 2015, pp. 53-54).

3) Constructional factors:

- Property rights issues. Nationalization have affected relationships with existing and potential investors on the peninsula – some of them, like

Avangardco, one of the world's largest egg producers had their assets nationalized and they try to gain compensation via court (Olearchyk, 2014). This fact undoubtedly shuns off not only foreign investors, but domestic ones as well – as we have stressed the importance of secured property rights for the very fact of economic development.



Map 1. North Crimean Canal. It starts in Tavriysk (Kherson oblast) and ends in Kerch (Crimea).

The overall fall in Crimean agriculture was not as big as it might have been because most of the consumption was already concentrated on the peninsula and the demand did not fell dramatically, so the sector was able to sustain without huge losses, though the prices for products have increased almost 30% in 2015 (Guild Hall, 2015). However, sector remains depressive and ascension to Russia could add to the list of problems increased competition with the renowned Russian agricultural players, such as Krasnodar Krai, which exports bulk of its agricultural products to the rest of Russia. In 2015 the crisis in the regional sector has led to the active intervention of producers from Kuban region to Crimean market (Liev, 2015). This problem is very likely to persist in future as agricultural producers from the mainland Russia are more

competitive than their Crimean counterparts, not least because of their advantage in the acreage: size of Krasnodar Krai's arable lands is 3.9 million hectares – more than Crimea's 1.8 million hectares (CP, 2015 – 2, p. 23).

As for the food safety, in this aspect the local sector could not provide enough supply for Crimea's needs – by September 2015 Ukrainian food made up around 40% of presented products in retail (Levinskaja, Himshiashvili and Galaktionova, 2015). This episode reflects difficulties of transition. However, blockade of peninsula started in September 2015 (Kopka, 2015; Polikanov, 2015) did not cause peninsula to starve.

6.5 billion rubles of investments into the development of peninsula's water resources (CP, 2015 – 2, p. 18) are scheduled to be dispersed till 2020, so the whole sector is very likely to suffer from the negative factors discussed from above in the foreseeable future. There are no huge development programs for the regions so far, so it is being kept on the optimum minimum subsistence levels by the non-decreasing local demand, generated in large part by seasonal factors, such as tourism. In theory, access to the internal Russian market with its abundance of consumers with relatively high purchasing power along with food embargo, later imposed by President Putin, should have boosted the sector in the region. But the starting conditions were unfavorable from the beginning and at the moment sector remains in the very difficult position, as it was acknowledged by the region's Minister of agriculture Andrei Grigorenko (EurRus, 2016). Some Ukrainian sources state that by the beginning of 2016 size of irrigated lands was only 13.4 thousand hectares, a tenfold decrease over 2 years (Sobytiya.Info, 2016).

Any further development in the sector depends on the willingness of investors and producers from the mainland Russia to take part in the development of the Crimean agricultural sector – and the ability of the state to encourage such development with developing needed infrastructure. Natural prerequisites for entry are good (a lot of arable land) and the existence of SEZ might serve as additional incentive, but first major problems (such as lack of water for irrigation) have to be solved. By the means of ensuring steady supply of the products to the peninsula, Kremlin

avoided the major food crisis and starvation in the region, but the costs of separation from Ukraine were too high not to take devastating effect on the sector's performance.

3.6 Transportation. Changes in this sector reflect changes in political sphere. In 2014 carrying capacity of airports increased almost 2.4 times in comparison to the levels of 2013 – up to 2.8 million passengers (MERRK, 2015, p. 48). Share of automobile transport has also increased – in the first year of annexation it carried 50% of all passengers and 21% of all cargo (Ibid. p. 49), though the number of all cargos transported this way decreased by 38% - to 1499.3 thousand tons. Ferries, on average, carried 20000 people and 4000 passenger cars a day (MERRK, 2015, p. 50) and their cargo turnover increased by 36% (FNEB, 2015, p. 58). Overall in the first year after annexation the cargo transportation fell by 32.8% (FNEB, 2015, p. 57-58), rates of railway transportation (that used to carry about half of commercial cargo transportation on the peninsula) contracted by 52,3% (Ibid.). Passenger transport carried 233.3 million passengers, 14% less than in 2013 (FNEB, 2015, p. 59). In Sevastopol fall was roughly the same (Ibid., p. 59-60). The following factors were the most important in this process:

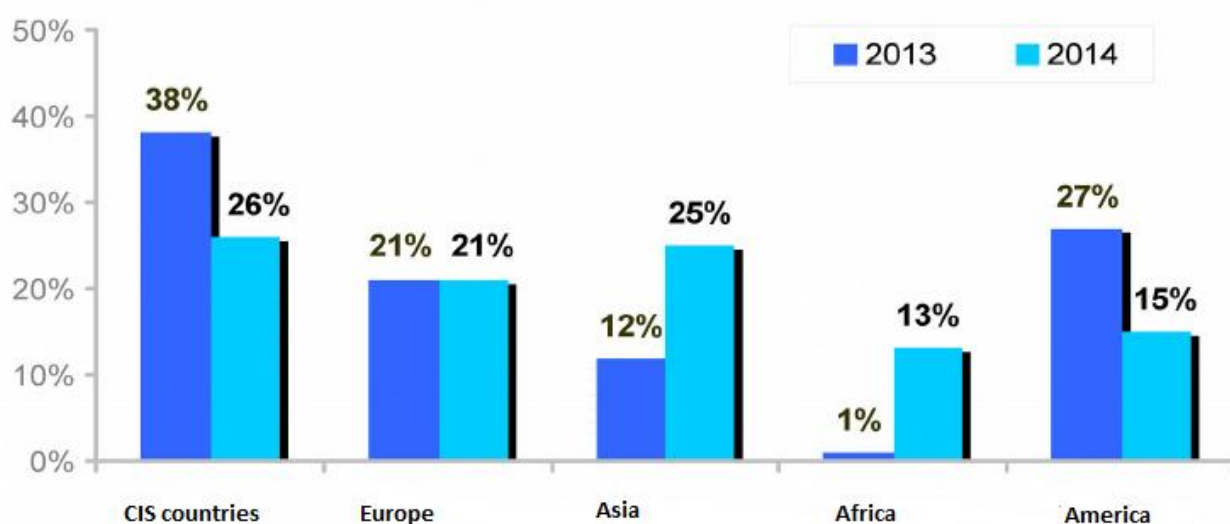
1) External factors:

- Separation from Ukrainian market hit the industries and sub-sectors most reliant on the railway transportation – tourism and raw material suppliers. Railways used to carry most of the tourists in Crimea before March 2014 (CP, 2015, p. 11): most of the tourists used to come from mainland Ukraine, which is connected to peninsula by land and railways and the already discussed switch of visitors to other transportation routes have seriously tested the infrastructural capacity on the peninsula. For the suppliers railways was one of the principal routes of transporting their materials to and from Crimea which is reflected in the sharp drop in transportation of the following goods: cement - 92.2%, ferrous metal scrap - 54%, oil and oil products - 75.9%, grain and grinding products - by 75.5%, coal – 64.1%, construction materials -

55.7%, fluxes - 33.5%, industrial raw materials - 30.7%, chemicals and soda – 23.7% (FNEB, 2015, p. 58). Since autumn 2014 Crimean residents are considered to be economic non-residents in mainland Ukraine (Klimenko et al., 2014) and that increases their transaction costs for those working in transportation sector;

- Blockade of peninsula. It is hard to estimate the damage done by the «civil blockade» of Crimea, which started in September 2015. At its peak organizers managed to decrease the number of Ukrainian goods entering Crimea by 1/3 (Interfax-Ukraine, 2015);
- Direct damage from sanctions. Freight turnover in port of Sevastopol fell 95% (Kostiaev, 2015);
- Disruption of foreign trade as ensuing consequence of the sanction. In the first year alone the exports of the region contracted by 70% (FNEB, 2015, p. 22). There was a strong increase in share of Asia and Africa in its structure, while the share of the US and CIS countries declined – it somehow reflects the results of vote in UN regarding annexation of Crimea, when countries from that regions voted against condemnation of Russia or abstained from voting altogether (Dolgov, 2014; UN, 2014). As other unrecognized territories Crimea tried to avoid sanctions by betting on re-export of its goods from Switzerland and Panama to US (FNEB, 2015, p. 22). New business environment complicated operations for the transporters, who already established commercial relationships with the counter-agents in US and EU and the closure of these markets in the result of sanctions have cost the industry dearly: one of the principal actors in the sector (38.1% of region's foreign exports in the beginning of 2014), chemical manufacturing, has suffered 17-fold decrease of its exports in price terms – from \$161 million to

\$9.3 million (Ibid.). Products made by Crimea still make their way to the European and American markets, just like its counterparts in Transnistria and Israel's territories on the West Bank, though in much smaller quantities than before and with more hurdles. Illicit nature of this trade and the permanent danger of disruption increase transaction costs for the players in the sector, thus complicating business environment for them and causing delays and shortening of activity. Some trade happens even between 2 parts of Cyprus, but it is estimated that the current trade is only a fracture of what it could have been under normal circumstances (Gokcekus et al, 2012).



Changes in the structure of Crimea's exports. Source: FNEB, 2015, p. 22

2) Constructional factor:

- Importance of illicit transactions increased. The blockade was incomplete: there were Ukrainian reports on the organizers letting the trucks to pass to Crimea for a certain fee (Groshi, 2015; Ilchenko, 2015) – this moment reflects one of the character traits of unrecognized entities – significant share of grey market and importance of illicit cross-border transactions. In fact, one of the reasons for the blockade was the large volumes of illicit trade (Gorodnichenko

and Talavera, 2015 – 2) between annexed region and the Ukrainian mainland, which refused to recognize the new de-facto status of this territory: Ukrainian exports to Crimea reached \$610 million in the first 8 months of 2015 alone and though the blockade from the land temporarily decreased the trade turnover and have put additional corruption transaction costs for suppliers and transporters on both sides of the border, it did not put an end to it. The trade between two parts of once unified state de-facto continues to that date, like in other unrecognized states – Transnistria (which trades with Moldavia) and others. Indirect confirmation of this fact would be the independent analysis of product prices in Crimea before, during and after blockade (Gorodnichenko and Talavera, 2015): the prices did not change dramatically during that period when the transport blockade hit the hardest, which implies that cargo carriers were still able to make their way to the peninsula by some other means. Of course it came at a price of increased transaction costs, associated with corruption, but nevertheless the blockade was not effective in the achieving full embargo – and as studied examples of unrecognized territories from our theoretical framework has demonstrated, some form of economic cooperation can take place even under the strictest sanctions. If Crimea’s legal status will not change in the years to come, such practices could become a routine and the part of institutional framework – like in Polish town of Nowa Huta, where during Communist times government was turning blind eye to the booming smuggling and black market, because there were no other ways to keep the economy of this region afloat (Janus, 1999).

3) Transitional factor:

- Lack of proper connection to the newly obtained Russian mainland causes lags in this sector. The disruption of access to the peninsula by land increased

pressure on the remaining transportation routes and it remains quite limited to that date despite all works for expansion of their carrying capacity. The Kerch Strait Bridge is expected to be opened no earlier than by the end of 2018 and its successful completion remains questionable because of geological situation in the region – tectonic shifts in the area where the bridge is being built will complicate its functioning in the future. Of course, land connection to Russia will increase trade turnover and tourist inflow and will altogether accelerate its integration with Russia, but it will still be under the threat of disruption, that might be caused by the natural disaster.

4) Inherited factors:

- Locked geographical positioning due to the being the small-island economy. As the territory that ceded from the only country, with which it shares border, Crimea was put into dangerous situation when it was unable to switch without losses to the logistics of the new mainland since the new transportation routes failed to compensate the same tonnage and passenger carrying, provided by previously used land routes. Though the new border remains penetrable, this route is not used to the full capacity and it is unknown whether it will be used at the pre-annexation rates again. In other words, Crimean small-island economy is still dependent on its previous metropolis in logistical sense;
- Quality of infrastructure. Most of the existing infrastructure on the peninsula was built in 1940-1950s (CP, 2015 – 2, p. 32), hence it needed modernization already at the moment of market transition. Insufficient funding in 1990s did not improve the overall situation and by the moment of annexation Crimea had lower quality of infrastructure than most of the Russian regions, which forced Russia to invest billions of rubles in its maintenance and reconstruction (Ibid., pp. 33-36).

Though the traffic from abroad has shrunk rapidly due to sanctions, there was still considerable presence of foreign transporters. For example, during the first year after annexation Crimea was visited by 94 ships from 14 different countries, including 4 NATO members – Greece, Turkey (Klimenko, 2015), Romania and Germany (Klimenko, 2014).

Up to the date transportation sector was going through severe crisis, caused by the problem discussed above. The completion of the Kerch Strait Bridge is meant to solve most of the problems – new roads and railways are expected to be built after its completion to carry increased number of cargo and passengers. It could be expected that after completion of the bridge and the subsequent increase in infrastructural development and usage transportation sector will get back to the peak levels of Ukrainian period – Russian economy is still big enough to provide Crimea with what it had under Ukraine. The likelihood of bypassing those levels depends on 2 crucially important factors:

- 1) Economic situation in the mainland Russia. It means not only the overall economic performance in the country, which will affect internal market fluctuations towards Crimea, but also availability of huge funds, needed, first, to build the sought infrastructure and, second, to keep it in the states appropriate for using – because Crimea is over-dependent on federal financing and cannot ensure funding of such projects on its own;
- 2) Sustainability of the Russian-built infrastructure in the face of two kinds of disruptions: natural ones and external. First means landscape challenging the bridge construction. Second are revolving on the situation in Ukraine, which means not only willingness of the government in Kiev to accept secession of the region, but also about possibility of other Ukrainian actors to intervene – for example, civil blockade was performed by nongovernmental actors from «The Mejlis of Crimean Tatar People». There is a huge possibility that other groups from Ukraine or loyal to it would choose to sabotage the infrastructure on the peninsula at their own initiative – autumn and winter of 2015 have

shown that Crimea is still vulnerable to that kind of actions. It is quite possible that representatives of the Crimean Tatar community on the peninsula would choose to participate in that process much more actively, thus bringing more militant element to existing strife.

3.7 Banking and finances. Combination of external factors related to the legal status of Crimea and transitional issues accompanying its integration resulted in a halt in lending, decrease in a number of banks and overall crisis in this sector.

This is one of the sectors, where transitional and external factors hit the hardest. Shortly after annexation Russian legislative body quickly passed law, obliging all banking institutions working in Crimea to obtain operating license from Russian regulators (Federal Law №37, 2014). Later, Ukrainian central banking authority issued decree, forbidding banks registered in Ukraine to operate in Crimea and made it known that the banks, that will stay there will have their banking license revoked in Ukraine (NBU №260, 2014). Cumulative effect of both laws was so strong that not only the Ukrainian banks started to withdraw from peninsula (Mereminskaja, 2014), but their Russian counterparts as well – because they were afraid to lose the bigger market of integral mainland Ukraine (Gubar, 2014; Krasnova and Verzhbickij, 2014). Foreign banks and their subsidiaries have left Crimea shortly after annexation due to the effect of two laws – among them were Credit Agricole Group, Reiffeisenbank, Piraeus Bank, BNP Paribas, Unicredit bank and OTP Bank (CP, 2015 – 2, p. 16)

Refusal of processing companies Visa and MasterCard to work in Crimea along with unavailability of international processing system SWIFT complicated banking operations and has increased reliance on operations with cash (Walker, 2015). Later, by the end of 2015 Russian government has found a way to bypass this and process Visa and MasterCard payments through newly established National Payment Card System (NPCS) which meant to establish financial independency of Russia (Ostroukh, 2015) it became possible to process Visa and MasterCard

payments through NPCB and those banks, that have reached settlement with the international processing systems (Eremina, 2015, 2016).

However, major Russian banks did not establish their presence on the peninsula and by February 2016 only a handful of banks continued to operate in Crimea. It is clear that they aim for internal Russian market or Crimea specifically and unlike major Russian banks, they don't have any interests abroad (Ideogram, 2016). In other words, after 2014 banking sector of Crimea exists primarily to establish the optimum minimum service level for the basic needs of population (infrastructure for processing salaries and social payments) and the existing business activity in the region. Under normal circumstances the number of banks would be much bigger. An indirect confirmation of this would be regulator's concern over the regional expansion of «Genbank» on the grounds of criminal records of one of its shareholders, who allegedly participated in illegal cashing schemes (Pismennaya and Reznik, 2016) – the latter usually served as preamble before Russian Central bank revokes license from a certain bank.

Multiple legal hurdles, which included new registration procedures and implementation of Russian legal norms led to the massive disruptions (Ovchinnikova, 2015, pp. 22-23) in banking activity. At first glance it appears that geo-political factor was principal, but in reality specifics of ascension to the Russian legal financial field has also contributed to the process: during first year of integration Russian Central Bank was actively revoking licenses from Crimean banks (Batalov, 2014). It could be argued how politically motivated these actions were if not the same tendency became apparent in mainland Russia well before annexation took place – from July 2013 to the December 2013 Russian Central Bank revoked 35 banking licenses (Stroz Friedberg, 2015) and this policy continued well into the present. It is true that international law issues have influenced decision of Russian major banks to abstain from establishment of long-term presence in Crimea, but there can be no doubt that even if annexation of Crimea received full international recognition, Russian Central bank would continue to close banks in Crimea, continuing its

consolidation policy in sector – under these circumstances existence of more than one hundred banks in such a small region would get questioned by the regulator in any case.

The situation with the banking sector on the peninsula is better reflected in the case of the region's largest bank – Russian National Commercial Bank (RNKB). After their withdrawal, major Russian banks handed their local operational offices to RNKB (CP, 2015 – 2, p. 17). Before the annexation of the peninsula RNKB was 609th in the Russian list of banks. Its rise to prominence started with Crimean annexation when it almost fully focused on the banking activities in the new region, occupying the niche (Hobson, 2014 – 2) and growing 3000% over the period of just 2 years (Volkova et al., 2016), effectively becoming an irreplaceable financial institution on the peninsula. Before the annexation, bank belonged to the Bank of Moscow, but shortly after it the ownership shifted to the new Crimean administration. After this the bank concentrated on the provision of the essential financial services to the population, maintaining important social function rather than acting out of the commercial interests. In the beginning of 2016 the bank has switched ownership again as it became property of Russia's federal state property agency – and by that time it was 90th banking institution the country out of total 700 (AFP, 2016) – that reflects its technical politicized nature.

To sum up, we will say that this sector suffered huge contraction and shrunk to the minimum optimum state, sufficient for provision of basic financial services to the population.

3.8 Telecommunications. This sector is also model in a sense, that it shows negative implications of Crimea's international status.

In April 2014 Russian company «Rostelecom» constructed its own underwater fiber optic communication line through Kerch strait, connecting Crimean communications system to the Russia, bypassing providers that became foreign after annexation (CP, 2015 – 2, p. 27).

Integration in the Russian legal and technical framework went smooth – in the first 6 months Ukrainian companies even continued to work on the peninsula, but later their services were suspended (Ibid., p. 28) – most likely due to the intensification of the conflict in Donbass.

Ukrainian companies were quickly replaced by the newly established Crimean bodies such as «Intertelecom» (independent company, based in Simferopol) and «K-Telecom» (Sergina, 2015) – scenario that was realized in the financial sector, where new banking institutions were quickly reinstated on the place of the old ones to guarantee access of the population to vital services.

But later the lags in the development of the sector began to emerge as the biggest Russian mobile providers became reluctant to engage in business on the peninsula due to the complications they could face in the mainland Ukraine where they have subsidiaries. On the contrary, major Russian providers of the fixed telephony, TV/radio and broadband Internet access have entered the regional market without fear (CP, 2015 – 2, pp. 29-30).

Hence the development of the sector was determined by the same set of factors that accompany economies of disputed territories:

- 1) External factor – Ukrainian sanctions, that forced major Russian companies to pull out from peninsula like their counterparts from banking industry did. Ukrainian laws make it possible to persecute companies, that somehow compromise Ukrainian territorial integrity and safety – and that makes work in annexed Crimea a highly risky enterprise (Salmanov, 2015). «MTS» has sold all of it equipment to «K-Telecom» (Salmanov, 2016) – the move, similar to the one, major Russian banks did with the transfer of their local branches to RNKB. Major Russian mobile communications companies shunned from working in Crimea (CP, 2015 – 2, p. 28), which is a good indicator of incomplete integration;
- 2) Constructional factor – Crimea uses workarounds to provide sought services. In that case it is work of Russian company MTS, which still operates in the region, distributing mobile and Internet connection from the neighboring Krasnodar, which makes its operations on the peninsula look compliant with international and Ukrainian laws. However, such moves bring additional transaction costs, such as keeping technical roaming – and that makes development of the territory to lag.

In telecommunications Crimea lags behind the absolute majority of the Russian regions, because factors discussed above constrain development of this industry. In future further development of this sector will be determined by how the local business and administration will be able to overcome factors discussed above. Kremlin was able to find substitute for optimal minimum level of development, when locals will be ensured with an access to the services of acceptable quality. However, this quality is deeply inferior to the standards on mainland Russia, where companies are reluctant to provide region with their funding and technologies, because their business interests abroad may suffer.

Summary. After annexation manufacturing, transportation and agriculture have suffered the most considerable drops because of the separation from Ukraine and the factors ensuing from the region's legal status – most notably fall of exports, decrease of demand and sanctions. This coincided with the negative trends already present in these sectors and Crimean economy in general and has added to the overall decrease – the features of small island economy overlaid with the features of disputed territory. Banking and telecommunications have suffered the most as effect of sanctions reduced the activity to the minimum and functioning in the area exists primarily due to the direct or indirect governmental support. Real estate sector is the only one which enjoyed huge growth on the speculative promises of the growth, fueled by the investment from the Russian mainland.

Sanctions and lack of proper connection to the Russian mainland are preventing complete integration of the region in Russian economy. Sanctions keeps major Russian banks and companies from doing business on the peninsula, which questions level of economic integration of the peninsula – this region cannot be fully considered part of the country in economic sense if legitimate economic actors shun from engaging in direct economic activities there. The infrastructural issues make Crimean economy over-dependent on the supply of crucial resources from Ukraine, the country which is not acknowledging the loss of the territory and hence is

acting in the disruptive way. In this sense, Crimea is much more fully integrated in Russia in political dimension, rather than in economic one.

The contraction in many industries and the ongoing crises related to the separation from Ukraine are showing that the poor quality of institutions in the region have deteriorated even further.

Crimea's illegal status encourages establishment of what Acemoglu and Johnson (2005) have called «extractive institutions», which do not encourage healthy economic development. Massive recession and hypothetical humanitarian catastrophe were prevented by ad hoc interventions by Russian central state – which also indirectly hints at the level of dysfunction of the institutions, existing on the peninsula: the ad hoc intervention from the Russian mainland (also in the form of subsidizing) is arguably the only thing that keeps the regional economy afloat.

Based on some growth evidences in particular sub-sectors and the expected investments, which in large part will come sometime after full infrastructural convergence of the region with the mainland Russia, we can expect gradual recovery and the growth of the peninsula's economy.

This model of economic development will largely resemble FRG's experience in integrating former GDR – politically motivated subsidization policy, which is not aiming at making the region self-sufficient, but at maintaining the social stability in region and narrowing the gap between more developed and less developed regions. With respect to Russian experience in regional development, still underdeveloped region like Dagestan may be the good example: in the period of 1999-2009 generous subsidization the region did not become economically self-sufficient, but increased its GRP, living standards and employment rates (Zubarevich, 2009, p. 15). Even without the constraints of the illegal status Crimean economy was over-dependent on the mainland in economic sense, but under current circumstances such dependency is likely to strengthen.

Poor quality of local governing institutions will lower positive effect from the Russian investments, but the Russian regional development experience demonstrates that money for such projects are distributed out of political considerations, thus giving little importance to increasing

costs and questionable effectiveness of such method of allocation of funds. The same should be expected in the case of Crimea.

These findings are consistent with what we have examined in our theoretical framework:

- Economic integration: in the process of developing Crimea Kremlin have confirmed the ideas of Mattli (1999) and Rosamond (2000) that the primary conditions for economic integration are political commitment and willingness to invest huge resources in this process. Policies from the examples of FRG and India, as well as from EU cohesion policy experience (Leonardi, 2004; Molle, 2008) are reminiscent of those we have seen in Crimea – generous investments for the sake of convergence of the region with the integrating country;
- Small island economies: Crimea did not change its nature (being over-dependent on the mainland) in that respect; the region just changed the mainland patron – from Ukraine to Russia. Thus, Crimea is still resembling models of development, studied by Briguglio and McElroy, as well as others, who did research in this area;
- Disputed territories: findings confirm Riegl's (2014) argument about negative trajectory of development of unrecognized states – the legal status of Crimea has affected development of the peninsula to the worst. In the process, the economic development of Crimea took shape similar to the other relevant disputed territories we have discussed in theoretical framework and was influenced by the same set of factors. It has also put limits on the integration of Crimea in Russia;
- Institutions: on the example of Crimea we have observed that the overall low quality of governing institutions (Acemoglu and Robinson, 2013) and the lack of security of property rights (Acemoglu and Johnson, 2005) serve as a negative factor. In addition to that we can state that the low quality of «institutional factors» such as skills, quality of infrastructure and others increase overall negative effect (Rodríguez-Pose, 2013; Siddiqui and Ahmed, 2013). Legal status of Crimea, as we have expected from studying the theory

(Olson, 2000; Varese, 2005), have affected region's institutions significantly and resulted in the development of the informal and illicit economic institutions, which usually appear in the case of troubled transition. So, in Crimea the integrating country has to deal with the economically underdeveloped region with the very low quality of institutions;

- Russian regional development: Kremlin did not make any changes in local institutions and instead of focusing on the developing long-term development agenda, it rather concentrated on the investments and provision of vital services for the period of connecting the region with the rest of Russia. This is consistent with our conclusions from that part of the framework, most vividly examined by Zubarevich (2009): the region is improving its social-economic indicators while remaining over-dependent on the financing from the center, which cares more about maintaining social stability, than about building sustainable and self-sufficient economy. This development pattern is also consistent with Crimea's model of small island economy, and with the notion of Russia being the country with huge regional economic divergence (Lehmann and Silvagni, 2013).

Conclusion

After collapse of the Soviet Union Crimea's economy shrunk and stagnated, while the periods of recovery growth were insufficient and short.

The core problem was that in its economic nature Crimea was small island economy, which depends on the mainland in most respects. The more rich the mainland is – the more positive effects Crimean economy will enjoy, and the opposite. In 1990s and 2000s Crimea was just as dependent on Ukraine as it was on USSR, but obviously Ukrainian economy could not offer the same. Long-term negative economic developments and deterioration of institutions in Ukraine had an effect on Crimean economy and led to the structural imbalances in many sectors. The degradation of Crimea's economy becomes even more evident when the region is being compared to the neighboring Krasnodar Krai, which had the different trajectory of economic

development. The reasons for that is the bigger size of the Russian market; relatively higher (though not especially) quality of institutions in Russia; delayed privatization in Crimea itself. Ascension of the region to Russia did not solve the principal problem. There is a hypothetical possibility that generous Russian subsidies will give a boost to local economy, but at the moment Crimean economy suffered and contracted because of transition. The status of disputed territory puts constraints on Crimea as sanctions and the conflict in Ukraine are affecting its performance in the negative way, combining with the already present negative features of underdeveloped post-Soviet economy. Additional weight is pulled by the poor quality of institutions, which remain unchanged.

However, the real economic development of the region will not start until the acceptable level of infrastructural connection will be established – it should be expected by the end of this decade. In that case there is a good potential for recovery and further development, because Russian economy offers Crimea more possibilities – especially when this growth is stimulated by the generous subsidies from the mainland.

So far economy of Crimea did not reach the full integration with Russia because of sanctions and infrastructural problems – both issues are preventing Russian business and consumers to engage in economic activity with Crimea as much as they could engage with other Russian regions. Crimea's development will largely depend on the possibility and willingness of Kremlin to put an effort and money in this project – like successful integration and development of Eastern Germany still depends on FRG's ability and readiness to do that at its expense.

Based on the Russian experience in regional economic development and the problems regional economy faces today, it will be safe to conclude that Russia will not seek to make Crimea fully self-sufficient and developed, as it would demand much more effort than could be expected – but rather will keep it on a lifeline of the subsidies like many other Russian regions (such as in North Caucasus), which otherwise would be totally depressive in economic sense.

Future researches on this subject could confirm or disprove our hypothesis that Crimea is likely to remain over-dependent on Russia in economic sense.

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