

GAIDAR INSTITUTE FOR ECONOMIC POLICY

**RUSSIAN ECONOMY IN 2011
TRENDS AND OUTLOOKS
(ISSUE 33)**

**Gaidar Institute
Publishers
Moscow / 2012**

UDC 330(470+571)
BBC 65.9(2Poc)-04

Agency CIP RSL

Editorial Board: *S. Sinelnikov-Mourylev (editor-in-chief),
A. Radygin,
N. Glavatskaya*

R95 **Russian Economy in 2011. Trends and Outlooks.**
(Issue 33) – M.: Gaidar Institute Publishers, 2012. 560 pp.

ISBN 978-5-93255-342-8

The review provides a detailed analysis of main trends in Russia's economy in 2011. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

UDC 330(470+571)
BBC 65.9(2Poc)-04

ISBN 978-5-93255-342-8

© Gaidar Institute, 2012

2.3. Intergovernmental Fiscal Relations and Subnational Finances

2.3.1. Subnational budgets in 2011

Principal trends regarding relations between different levels of power are reflected in the structure of revenues and expenditures of the consolidated budget of the Russian Federation. *Table 18* shows a share of tax revenues and expenditures of the constituent territories of the Russian Federation in the relevant items of the consolidated budget of the Russian Federation.

Table 18

**A share of the selected items of subnational budgets
in the consolidated budget of the Russian Federation in the period
between 1996 and 2011 (%)**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Tax revenues	49.5	53.1	56.6	49.2	43.5	37.4	35.1	39.6	36.1	30.9	31.8	33.9	33.2	36.6	37.2	33.1
Tax revenues net of mineral payments and customs duties	55.8	59.5	59.9	55.0	49.0	42.6	40.1	41.9	47.5	49.1	52.0	50.5	53.7	54.8	57.1	56.0
Expenditures	45.4	48.1	54.1	51.9	54.4	51.2	49.3	50	50.8	49.5	43.4	48.3	49.2	43.4	43.2	46.5

Source: Federal Treasury, Gaidar Institute's estimates.

The data in *Table 18* shows that from 2001 a share of tax revenues of the constituent territories of the Russian Federation in tax revenues of the consolidated budget of the Russian Federation decreased below 40% and remained as such over the following decade (a minimum value of 30.9% was reached in 2005). Such a distribution of tax revenues among the budget system levels over the recent decade has to a large extent resulted from a higher growth rates in federal budget revenues generated from oil and gas¹ vs. growth rates in tax revenues of subnational budgets. Furthermore, the global recession which came to a boil in 2009, resulted in a bigger share, an increase to 36.6% in 2009 from 33.2% in 2008, of tax revenues of the constituent territories of the Russian Federation in the respective consolidated budget revenues of the Russian Federation. It resulted basically from a slump of the federal budget revenues from mineral production tax and customs duties. Meanwhile, a share of regional budgets, net of mineral payments and customs duties, also increased a bit by 1.1 p.p., to 54.8% from 53.7% in 2009, which was basically conditioned by steady inflow of revenues from personal income tax during the period of recession (Rb 1666,2bn in 2008 and Rb 1665,8bn in 2009).

In 2011, however, a share of tax revenues of subnational budgets in the consolidated budget of the Russian Federation decreased once again by 4.1 p.p. to 33.1% vs. 2010 (the value is close to a pre-recession value of 33.2% in 2008) as prices of exported energy recourses in-

¹ Pursuant to Clause 2, Article 96.6 of the Budget Code of Russia, the following federal budget revenues shall be deemed to be revenues generated from the production of oil and gas: tax on the production of minerals as crude hydrocarbons (crude oil, flammable natural gas extracted from all types of raw hydrocarbon deposits, gas condensate extracted from all types of raw hydrocarbon deposits); export customs duties on crude oil; export customs duties on natural gas; export customs duties on petroleum products.

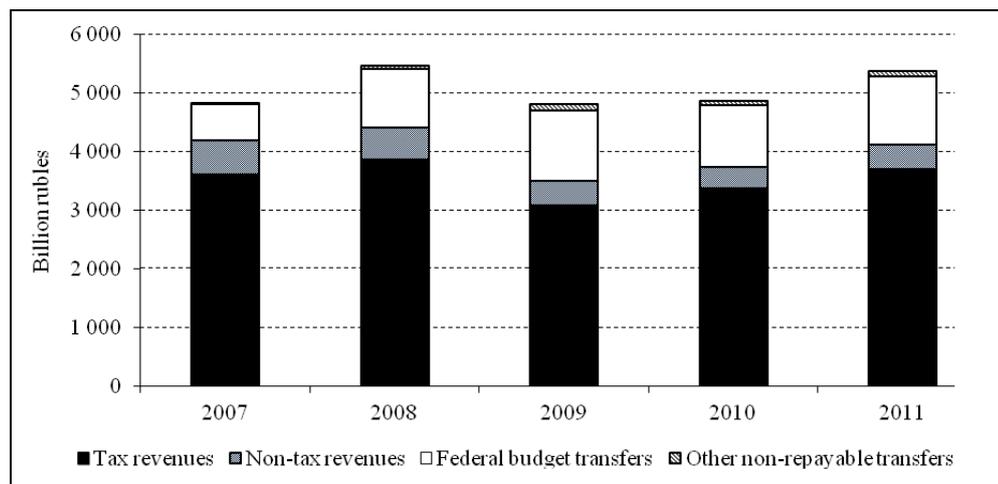
creased. In 2011, revenues from mineral production tax increased by 44.7% in nominal terms while revenues from customs duties, including the revenues generated within the framework of agreements concluded within the Customs Union, increased by 57.5% against 2010. As a result, tax revenues of the federal budget increased in general almost by 40% in nominal terms. Meanwhile, tax revenues of consolidated regional budgets increased merely by 16.7% in 2011 against the percentage reported in 2010. Therefore, in 2011 the decrease in a share of tax revenues of subnational budgets in the consolidated budget of the Russian Federation was basically conditioned by higher growth rates of tax revenues payable to the federal budget vs. the growth in taxes payable to subnational budgets. A share of tax revenues of consolidated regional budgets, net of mineral payments and customs duties, decreased less, by 1.1 p.p., to 56.0% from 57.1%.

However, a share of expenditures of subnational budgets in the consolidated budget expenditures of the Russian Federation increased significantly to 46.5% in 2011 from 43.2% in 2010, which, however, was by 2.7 p.p. less than the relevant value recorded in the pre-recession period of 2008. Budget expenditures of the constituent territories of the Russian Federation accounted for 15.05% of GDP in 2008 and by 0.93 p.p. or 14.12% less in 2011. A share of regional expenditures decreased gradually in GDP from 2009 (max. value of 16.13% of GDP). It should be noted, however, that in 2011 subnational budget expenditures increased in real terms by 9.0% and federal budget expenditures by 1.9% against the relevant percentage reported in 2010. Meanwhile, federal budget expenditures tended to decrease in percentage of GDP (to 20.1% in 2011 from 24.85% in 2009) from the beginning of 2009, the same is true of consolidated budget expenditures of the constituent territories of the Russian Federation. The decrease in expenditures in percentage of GDP in the post-recession period was therefore partially conditioned by outrunning growth in the GDP itself.

Let us examine in detail the situation with subnational budget **revenues**. *Fig. 17* presents the dynamics of the principal components of consolidated budget revenues of the constituent territories of the Russian Federation in the period between 2007 and 2011.

In 2011, consolidated budget revenues of the constituent territories of the Russian Federation increased in real terms by 9.9% y-o-y. A share of such revenues in total regional budget revenues decreased a bit to 69.4% from 69.6%. In spite of growth in tax revenues in the period between 2010 and 2011, the pre-recession level of 2008 was not regained. Tax revenues decreased in real terms by 4.3% in 2011 vs. the percentage reported in 2008. Hence it is a reflection of the fact that tax revenues of regional budgets failed in general to regain the pre-recession level both in terms of inflow volume and a share in total revenues (the value stood at 70.7% in 2008). In spite of a 13.5% growth in real terms in 2011 vs. 2010, non-tax revenues also failed to regain the pre-recession value (a decrease of 16.5% against 2008). High level of non-tax revenues in 2007–2008 was secured basically by increased revenues generated from the use of state- and municipally-owned property assets against 2009–2010. In 2011, these revenues increased in real terms by 17.9% against 2010 but failed to regain the level of 2008 (a decrease of 17.0%). In general, this type of revenues accounted for at least 43.1% of non-tax revenues in the period between 2007 and 2011. As a result, while a share of non-tax revenues accounted for 9.8% of total revenues of the budget of the constituent territories of the Russian Federation in 2008, it decreased down to 8.7% in 2009 and 7.7% in 2010, but increased to 7.9% in 2011. The amount of transfers from the federal budget also increased in real terms and stood at 10.5% in 2011 against the percentage reported in 2010 (budget transfers decreased by 13.5% in the post-recession period of 2010 against 2009). As a

result, the amount of transfers in 2011 was bigger in comparable values by 15.6% vs. 2008, which, however, was by 4.3% less than in 2009. Other non-repayable revenues grew in real terms by 3.9% in 2011 against the percentage reported in 2010. It should be noted that in spite of growth in this type of revenues, they have been accounting for 1.7% or less of the total revenues generated over the recent two years. Like in the preceding year, revenues from the Foundation for Support to the Housing and Community Amenities Reform accounted for a major part of other non-repayable transfers. In general, subnational budget revenues increased in real terms by 10.3% in 2011 vs. the percentage reported in 2010, but decreased by 1.2% vs. 2008.



Source: Federal Treasury, Gaidar Institute's estimates.

Fig. 17. Consolidated budget revenues of the constituent territories of the Russian Federation in the period between 2007 and 2011, by component (at 2007 values)

The dynamics of principal taxes payable to the consolidated budget of the constituent territories of the Russian Federation in the period between 2007 and 2011 is shown in *Table 19*.

In general, tax revenues of consolidated budgets of constituent territories of the Russian Federation in percentage of GDP decreased from 10.01% of GDP in 2010 to 9.70% of GDP in 2011, which was even less than by 0.07 p.p. of GDP in 2009. The dynamics of specific taxes was multidirectional. Historically, there are two taxes which account for a major part of tax revenues of subnational budgets, namely corporate tax and personal income tax which accounted for about 74.4% of total tax revenues in 2011, a bit higher than in 2010 (73.2%) but lesser than in 2008 (78%). This can be explained basically by that profit tax revenues were much less than the revenues generated in 2008 (4.24% of GDP), although they increased by 0.19 p.p. of GDP and reached 3.55% of GDP. It should be taken into account that the regional rate of this tax increased from 19.5 to 20% from January 1, 2009. Therefore, though the trend towards economic recovery continued in 2011 thereby resulting in more profit tax revenues, its share in GDP still remained too far from the pre-recession values. The dynamics of another principal type of tax – personal income tax – was not the same. Revenues from personal income tax were found to be most stable among other types of tax revenues of consolidated regional budgets amid recession. In 2011, revenues from this tax saw a decrease by 0.29 p.p. down to 3.67% of GDP vs. 2010. The decrease in revenues from personal income tax in per-

centage of GDP from 2009 (when a maximum value of 4.29% of GDP was reported) can be explained basically by outstripping growth rates in GDP in the post-recession period against growth in the average gross nominal wages in the economy (which increased by 12.2 in 2011 against 2010, according to the Rosstat's preliminary data). Furthermore, nominal GDP increased in 2011 by 17.8% y-o-y. Personal income tax increased by merely 11.4% in nominal terms over the same period.

Table 19

Tax revenues payable to the consolidated budget of the constituent territories of the Russian Federation in the period between 2007 and 2011 (% of GDP)

	2007	2008	2009	2010	2011
Tax revenues, total	10.88	10.62	9.77	10.01	9.70
including:					
Corporate tax	4.60	4.24	2.76	3.36	3.55
Personal income tax	3.81	4.04	4.29	3.96	3.67
Excise duties on products sold on the territory of the Russian Federation	0.54	0.46	0.63	0.73	0.68
Gross income taxes	0.37	0.39	0.39	0.40	0.40
Property taxes	1.24	1.20	1.47	1.39	1.25
Taxes, duties and regular payments for the use of mineral resources	0.23	0.25	0.19	0.07	0.07
<i>For reference: GDP, trillion Rb</i>	<i>33.24</i>	<i>41.27</i>	<i>38.80</i>	<i>45.16</i>	<i>54.36</i>

Source: Federal Treasury, Gaidar Institute's estimates.

The following should be noted through examination of the dynamics of other types of tax revenues of the consolidated budget of the constituent territories of the Russian Federation. Revenues from excise duties decreased a bit by 0.05 p.p. in percentage of GDP in 2011 against 2010. Moreover, pursuant to the adopted amendments to the Tax Code of the Russian Federation, the rates of excise duties will grow in the ensuing years¹, which is likely to change the recently visible downward trend in the relevant revenues. A share of taxes payable by small businesses (on their gross income) remained almost the same over the period under review and stood at 0.4% of GDP, like in the preceding year. Property tax revenues also tended to decrease from 1.47% in 2009 to 1.25% of GDP in 2011 (which, however, is 0.05 p.p. above the level reported in 2008). A share of mineral production tax and other payable mineral payments in the regional budget revenues stabilized at the level of 0.07% in period between 2010 and 2011 after a stable downward decrease in 2009–2010. Such a small value of revenues from this source of revenues can be explained by centralization from 2010 of revenues from the tax imposed on the production of minerals as crude hydrocarbons payable to the federal budget².

The foregoing dynamics refers in general to tax revenues of the consolidated budget of the constituent territories of the Russian Federation. However, it would be reasonable to make analysis by region, because the constituent territories of the Russian Federation differed largely in the depth of recession and the degree of economic recovery. It should be noted that differentiation of tax revenues between regional budgets decreased in 2009, but then increased again in 2010. The relevant variation of per capita tax revenues adjusted for the budget expenditure index stood at 87.2% in 2008 (75.0% in 2009), increased to 91.3% in 2010, but de-

¹ Refer to Clause 1, Article 193 of the Tax Code of the Russian Federation.

² The standard for payment of the tax on the production of minerals as crude hydrocarbons to the federal budget (save for flammable natural gas) has been increased from 95 to 100% since January 1, 2010 (under Federal Law No. 218-FZ, dd. 22.09.2009 "On the Amendments to the Selected Legal Acts of the Russian Federation and Cancellation of the Selected Provisions of Legal Acts of the Russian Federation").

creased to 77.7% in 2011. The following factors were responsible most to this dynamics. It was the economically developed regions that were hit hardest (they experienced a deeper recession) by the crisis, which resulted in a decrease in the interregional differentiation. From the end of 2009, the Russia's economy began to recover, but the constituent territories of the Russian Federation differed largely in the degree of such recovery and, consequently, growth rates of tax revenues, which resulted in increase of differentiation of per capita tax revenues. In 2011, the differentiation declined as a result of a certain equalization of recovery rates in the economies in different groups of regions.

Tools which allow profit tax revenues to be distributed more evenly among the constituent territories of the Russian Federation, began to work from 2012 in order to reduce differentiation of tax revenues in various regions. This refers to the amendments to the Tax Code of the Russian Federation which concern the control of transfer pricing and introduction of the concept of consolidated group of taxpayers¹. The amendments imposed a higher degree of control among related companies in order to create extra obstacles against using transfer pricing for the purpose of moving the "profit center" through various regions. However, the amendments allow taxpayers to form a consolidated group thereby allowing them to make special consolidated reports. The advantage of this approach is that corporate profit tax is to be paid on the basis of financial performance results of the consolidated group of taxpayers. In doing so, profit tax is to be accrued and tax revenues are to be distributed between various regions in which companies within the consolidated group operate pursuant to the regulations set forth in Clause 6, Article 288 of the Tax Code of the Russian Federation. A share in the profit of a specific company is to be measured as an arithmetical mean of a share of the average number of workers (wage costs) of the company and a share of depreciation value of amortizable assets in relevant values for the entire consolidated group. The amount of profit tax itself is to be measured on the basis of a tax rate applicable in the constituent territory of the Russian Federation where a certain member (and/or its stand-alone unit) of the consolidated group is located. Therefore, the aforesaid regulations allow the profit tax base to be more evenly distributed among the regions of Russia.

However, legislative regulations concerning transfer pricing and consolidated group of taxpayers, which have been in effect since 2012, impose strict requirements to such consolidated group. This is why the number of companies, i.e. potential members of consolidated groups of taxpayers is not going to be large, up to 40–50, in the short-term period. It should be emphasized that it will be Moscow which will incur most losses from the application of the new regulations vs. other regions, because head offices of most of large Russian companies are located in Moscow. However, considering high fiscal capacity of this region (3,232 in 2011²), there is no point to expect any significant deterioration of its revenue potential, which disputes the need for large-scale compensatory arrangements. It should be understood that the larger the scale and longer is the duration of such compensations, the lesser the "equalizing effect" of taken measures will be in the short-term period.

¹ Federal Law No. 321-FZ, dd. November 16, 2011 "On the Amendments to Part 1 and Part 2 of the Tax Code of the Russian Federation Due to the Creation of the Consolidated Group of Taxpayers"; Federal Law No. 227-FZ, dd. July 18, 2011 "On the Amendments to the Selected Legal Acts of the Russian Federation Due to Perfection of the Pricing Principles for the Purpose of Taxation".

² According to the Method for allocation of grants for fiscal capacity equalization of the constituent territories of the Russian Federation for 2011.

Let us examine in detail the situation with tax revenues by constituent territory of the Russian Federation. *Table 20* presents a breakdown of Russia's regions by change in tax revenues in the period between 2008 and 2011.

Table 20

A breakdown of Russia's regions by change in tax revenues of the consolidated budget of the constituent territories of the Russian Federation

Number of regions in which tax revenues in 2011	In nominal terms		In real terms	
	2011 vs. 2010	2011 vs. 2008	2011 vs. 2010	2011 vs. 2008
Increased by more than 25%	8	55	4	6
Increased from 10 to 25%	61	20	20	21
Increased by less than 10%	12	5	53	27
Decreased by less than 10%	1	1	4	20
Decreased from 10 to 25%	0	1	1	7
Decreased by more than 25%	0	0	0	1

Source: Federal Treasury, Gaidar Institute's estimates.

The foregoing data shows that tax revenues of the consolidated regional budget increased in real terms in 54 of 82¹ constituent territories of the Russian Federation in 2011 (the second year of economic recovery) against 2008. The following regions were leading in terms of growth rates: the Republic of Ingushetia, the Karachay-Cherkessia Republic, the Chechen Republic, the Magadan Region, the Chukot Autonomous Area, the Republic of Adygeya. At the same time, tax revenues decreased by 30.41% in the Vologda Region. Comparing the data on 2011 and 2010, one may note that 77 regions saw an increase in tax revenues in real terms. Furthermore, almost all the regions saw an increase in nominal terms, save for the Republic of Altai. The Tyumen Region and Vologda Region experienced a decrease in nominal terms in 2011 vs. the percentage reported in 2008.

Let us examine the changes which took place in the consolidated budget **expenditures** of the constituent territories of the Russian Federation. Aggregate expenditures of the consolidated budget of the constituent territories of the Russian Federation increased in nominal terms by 15.6% in 2011 against 2010. However, their growth in real terms was merely 9.0%. The structure of expenditures of the consolidated budget of the constituent territories of the Russian Federation saw certain changes as well (*Table 21*).

The following should be noted on the basis of analysis of changes in regional budget expenditures by item. A share of expenditures on 'National Economy' and 'Education' increased a bit and stood at 17.1% and 22.5% respectively in 2011 against 16.6% and 21.9% in 2010. On the contrary, a share of expenditures on 'Social Policy' decreased to 15.5% of total expenditures in the same period (17.6% in 2010). Expenditures on 'National Security and Law Enforcement', 'Environmental Protection' and 'Culture, Cinematography and Mass Media' remained the same vs. 2010.

Table 21

Structure of consolidated budget expenditures of the constituent territories of the Russian Federation in the period between 2008 and 2011 (%)

	2008	2009	2010	2011*
Nationwide Issues	7.1	7.3	7.3	7.1
<i>Including State and Municipal Debt Service</i>	0.6	1.0	1.1	1.0

¹ The Arkhangelsk Region and the Nenets Autonomous Area are regarded as the single constituent territory of the Russian Federation.

	2008	2009	2010	2011*
National Defense	0.0	0.0	0.0	0.0
National Security and Law Enforcement	4.1	3.9	3.8	3.7
National Economy	19.6	18.1	16.6	17.1
Housing and Community Amenities	16.3	13.7	12.6	12.6
Environmental Protection	0.3	0.3	0.2	0.3
Education	20.8	21.5	21.9	22.5
Culture, Cinematography and Mass Media	3.5	3.4	3.4	3.5
Healthcare and Sports	12.7	12.1	12.0	11.1
Social Policy	12.2	15.3	17.6	15.5
Interbudget Transfers	3.3	4.4	4.5	6.5

*Expenditures in 2011 are presented in a comparable classification which was in force until 2011.

Source: Federal Treasury, Gaidar Institute's estimates.

Expenditures on 'Healthcare and Sports' saw a more considerable change, with a downward trend over the recent four years, from 12.7% in 2008 to 11.1% in 2011. Expenditures on healthcare saw a marked decrease in 2011 basically due to an increase in a share of regional budget transfers to territorial funds for compulsory medical insurance. Examining this dynamics, it should be taken into account that contributions (transfers) for economically enactive population have become standardized and mandatory since 2011, in other words, regions no longer may reduce considerably the amount of such contributions (which resulted in their marked increase also as a result of a certain cut-off in direct regional budget expenditures on healthcare). As a result, the accumulative share of the two items – 'Healthcare and Sports' and 'Interbudget Transfers' – increased to 17.6% in 2011 from 16.5% in 2010. A share of expenditures on 'Nationwide Issues' decreased by 0.2 p.p. to 7.1% in the last year, and a share of expenditures on 'State and Municipal Debt Service' also decreased a bit from 1.1% to 1.0% of total regional expenditures.

A special focus should be placed on 'National Economy'. The dynamics here should be examined both for the item as a whole and its sub-items, because this type of expenditures is quite homogeneous vs. other types. After a stable upward trend, a share of expenditures on agriculture decreased for the first time to 3.0% of total expenditures (a max. of 3.4% was reached in 2010). In general, expenditures on 'General Economic Issues', 'Fuel and Power Sector', 'Applied Research in the Field of National Economy' saw a decrease against 2010. Such sub-items as 'Water Industry' (83.4%) and 'Forestry' (69.4%) were leading in terms of growth rate. However, a share of these expenditures still remains insignificant. A special emphasis should be placed on such sub-items as 'Transport' and 'Road Facilities', which in 2011 accounted for 8.3% of total expenditures on 'National Economy', a growth of 0.4 p.p., 7.9% against 2010 (refer to *Section 2.3.4* for more details on the expenditures on road facilities).

In 2011, a combined subnational budget **deficit** remained unchanged, but its volume decreased to 0.5% of total expenditures, which is much smaller vs. 5.3% in 2009 and 1.5% in 2010. Analyzing the budget deficit value by constituent territory, it should be noted that only 26 of 83 regions saw a surplus of their consolidated regional budget at year-end 2011. As a result, the need for borrowing was maintained at the subnational level. It should be noted that the need for fundraising might have emerged also because of the need for refinancing of the existing debt. The data on volumes of government debt of the constituent territories of the Russian Federation in the period between 2007 and 2011 and municipal debt in period between 2010 and 2011 is shown in *Table 22*.

Table 22

**Government debt due by the constituent territories of the Russian Federation
in the period between 2007 and 2011 and municipal debt
in the period between 2010 and 2011 (Rb, billion)**

	Debt amount, Rb, billion				
	as of January 1, 2008	as of January 1, 2009	as of January 1, 2010	as of January 1, 2011	as of January 1, 2012
All constituent territories of the Russian Federation	456,9	599,6	889,6	1096,0	1071,9
including:					
Moscow	89,3	121,5	243,1	299,3	263,0
Moscow Region	92,1	156,1	163,7	146,8	96,1
Constituent territories (net of Moscow and the Moscow Region)	275,4	322	482,8	649,9	712,7
Municipalities	n/a	n/a	134,9	169,8	197,7

Source: Ministry of Finance of Russia, Gaidar Institute's estimates.

The data on changes in absolute volumes of government debt by constituent territory of the Russian Federation in 2011 show some decrease in borrowings (a decrease of Rb 24,1bn). However, such a decrease resulted basically from a considerable decrease in volumes of government debt in Moscow and the Moscow Region. In addition, these two regions accounted for more than 30% of total government debt due by the constituent territories of the Russian Federation. Examining the dynamics of regional debt amounts, net of Moscow and the Moscow Region, the picture would be different. The amount of government debt due by the other constituent territories of the Russian Federation increased to Rb 712,7bn by January 1, 2012, a growth of Rb 62,8bn vs. the beginning of 2011. Total municipal debt increased by Rb 27,9bn of the period.

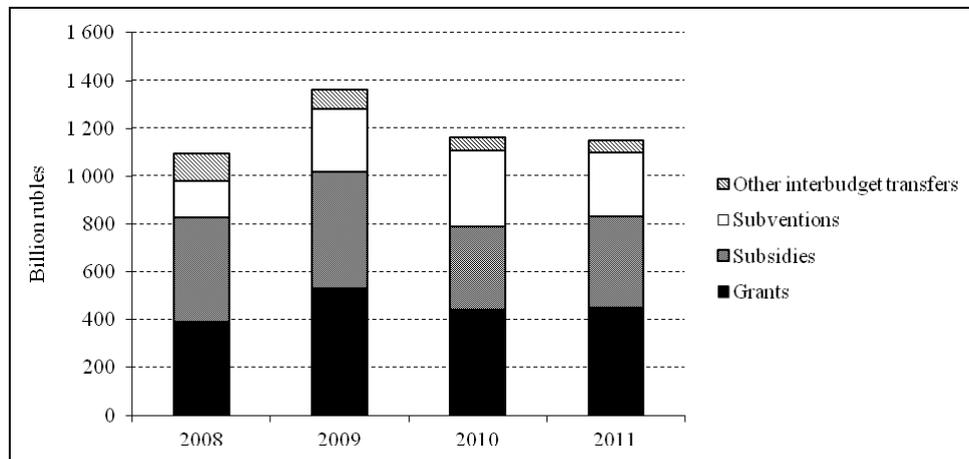
The following should be noted on the basis of the results of the second year of Russia's economic recovery. The situation with the fulfillment of subnational budgets in 2011 improved visibly. However, a series of the principal parameters describing the situation with subnational finances remained lower than the pre-recession values. For example, tax revenues decreased in real terms by 4.3% in 2011 vs. the pre-recession values of 2008. No pre-recession values were regained for a series of the principal taxes, namely profit tax (a decrease of 12.4%), personal income tax (a decrease of 4.6%). The level of expenditures failed to reach the pre-recession values (a 2.3% cut-off), above all, through a lower level of capital expenditures. At the same time, expenditures on 'Social Policy' (which is ranked third in size after the 'National Economy' and 'Education') increased in real terms by 24.4% (vs. the percentage reported in 2008). A major part of the regions failed to fulfill their budget without a deficit. As a result, in spite of general easing of the economic situation (growth in GDP and industrial output), a certain tension still remains in place with regard to the budget fulfillment in certain regions.

2.3.2. Financial support from the federal budget

The total amount of federal budget transfers to subnational budgets increased in nominal terms by 4.8% in 2011, but decreased in real terms like in the preceding year (by 1.2% in 2011; 14.4% in 2010 vs. the percentage reported in 2009). The balance of extended and repaid budget loans decreased by 51.5%, from Rb 164,4bn to Rb 79,8bn. It should be noted that in 2011 the amount of extended federal budget loans to the regions decreased by Rb 41,7bn to Rb 128,4bn. The balance decreased visibly as a result of a substantial growth in repayments

for budget loans by the regions, from Rb 5,4bn in 2010 to Rb 48,6bn in 2011, which was basically conditioned by repayment of 3-year budget loans extended in 2009.

Let us examine in detail the dynamics of certain types of federal budget transfers (refer to *Fig. 18*).



Source: Federal Treasury, Gaidar Institute's estimates.

Fig. 18. Federal budget transfers to Russia's regions in the period between 2008 and 2011 (at 2008 values)

Subventions and other interbudget transfers (hereinafter – “other IBTs”) decreased in real terms in 2011 vs. 2010. Subventions decreased most, by 16.0%, other IBTs by 8.9%. However, comparing the amounts of these transfers in 2011 with 2008, it should be noted that subventions increased in real terms by 75.4% whereas other IBTs decreased by 56.2%. Subsidies in 2011 increased by 10.2% vs. the percentage reported in 2010 (however, it was 12.1% less than in 2008). The amount of grants decreased markedly and stabilized at Rb 563,5bn in 2011 over the recent two years (a growth of 1.6% in real terms vs. 2010) after a substantial growth in 2009.

The foregoing dynamics resulted in certain changes in the structure of transfers in the period between 2008 and 2011 (refer to *Table 23*).

As evident from *Table 23*, the amount of grants increased in 2011 against 2010 mostly through an increase to Rb 154,3bn from Rb 105,9bn in the amount of grants allocated for the provision of support to budget balancing measures. As a result, a share of grants for fiscal equalization increased from 7.7% to 10.7% of total amount of transfers. However, a share of grants for budget balancing decreased to 27.5% from 28.8%. Grants accounted for 39.0% total interbudget transfers in 2011, a growth of 1.1 p.p. vs. 2010. In general, the data on changes can't be single-valued, because grants for budget balancing are allocated through a more transparent method based on objective factors against grants for fiscal equalization. In spite of the fact that a certain part of grants for budget balancing are allocated on the basis of publicly available methods and rules, many applicable criteria and indicators are less grounded and intrinsic vs. allocation of grants for fiscal equalization. A new type of financial support to the regions appeared in 2011, namely grants to the constituent territories of the Russian Federation which achieved best results in increasing the regional taxable capacity, which are also allocated as grants for budget equalization (refer to Section 2.3.3 for details).

Table 23

**Federal budget transfers to Russia's regions
in the period between 2008 and 2011, in nominal terms**

	2008		2009		2010		2011	
	m Rb	% of total						
Transfers to the regions, total	1,094,680	100.0	1,480,385	100.0	1,378,337	100.0	1,445,581	100.0
Grants	390,398	35.7	578,277	39.1	522,685	37.9	563,500	39.0
including:								
grants for fiscal capacity equalization	328,648	30.0	375,485	25.4	396,996	28.8	396,996	27.5
grants for the provision of support to budget balancing measures	46,035	4.2	191,886	13.0	105,955	7.7	154,270	10.7
Subsidies	435,867	39.8	530,073	35.8	411,439	29.9	481,252	33.3
including:								
subsidies for road facilities	101,799	9.3	104,304	7.0	61,437	4.5	57,643	4.0
agricultural subsidies	73,593	6.7	90,641	6.1	87,930	6.4	98,509	6.8
Subventions	153,170	14.0	284,440	19.2	378,650	27.5	337,467	23.3
including:								
subventions for exercising the powers in employment promotion	37,413	3.4	77,414	5.2	87,090	6.3	74,193	5.1
subventions for GPW veteran housing	0	0.0	45,825	3.1	116,851	8.5	46,054	3.2
Other interbudget transfers	115,245	10.5	87,595	5.9	65,562	4.8	63,362	4.4

Source: Federal Treasury, Gaidar Institute's estimates.

A share of subventions decreased from to 23.3% in 2011, 27.5% in 2010 in total amount of transfers. The decrease in the amount of subventions was conditioned basically by a decrease in subventions for exercising the authority in promotion of employment and subventions for the Great Patriotic War veterans housing due to the 65th Anniversary of the Victory in the Great Patriotic War (1941-1945)¹ which appeared in 2009. It is the latter type of subventions that resulted in a substantial decrease in 2011, when a share of this subvention became twice as little, i.e. they decreased from 8.5% to 3.2% of total amount of transfers.

A share of subsidies in total amount of transfers decreased continuously in 2009–2010 from 39.8% in 2008 to 35.8% in 2009, and stood at mere 29.9% in 2010. On the contrary, a share of subsidies increased by 3.4 p.p. to 33.3% in 2011.

Following are the principal lines of co-financing of subnational budget expenditures in 2011:

- the state program on agricultural development and regulation of the markets of agricultural products, raw materials and food products for the period of 2008–2012 (20.5% of total amount of subsidies, 21.4% in 2010);
- construction and modernization of motor roads (12.0%; 14.9% in 2010)²;
- financing additional medical assistance provided by district general practitioners and pediatric physicians, general practitioners (family doctors) (4.5%; 5.1% in 2010).

¹ Pursuant to Edict of the President of the Russian Federation No. 714, dd. 07.05.2008 “On the Great Patriotic War (1941–1945) Veterans Housing”.

² The amount of these subsidies includes relevant expenditures as part of all federal special purpose programs.

- implementing additional measures aimed at easing the tension in the labor market of the constituent territories of the Russian Federation (3.7%, in 2010 – 9.4%).

In general, speaking of the principal parameters of federal budget transfers to the regions in 2011, the following should be noted. A share of grants and subsidies increased a bit and a share of other IBTs and subventions decreased in total amount of federal budget transfers vs. 2010. Comparing the transfers made in 2011 with those in 2008 (the ‘pre-recession’ period), it should be noted that a share of subventions increased substantially and a share of other IBTs decreased in the total amount allocated to subnational budgets transfers. In general, the federal center made efforts concerning intergovernmental fiscal relations in 2011 which were intended to keep gradually curtailing principal “counter-recession” channels of aid to subnational budgets and simultaneously create additional stimuli for increasing the tax base (this refers, above all, to “stimulus” grants whose allocation method is described in detail in the next section).

2.3.3. Stimulating the constituent territories of the Russian Federation which achieved best results in enhancing regional taxable capacity

There has been a visible trend over the last few years towards wider use of the practice of federal budget allocations to the regions on the basis of their economic and financial performance results. Since 2007, the Ministry of Regional Development of Russia has been measuring effectiveness of executive branches of the government of the constituent territories of the Russian Federation¹, and grants are allocated to regions which are found to be most “efficient” based on such measurement. In addition, at the end of 2011, the federal government bodies made a decision on creating a stimulus arrangement for those constituent territories of the Russian Federation which managed to achieve best results in their economic development and fundraising. A total of Rb 10bn was allocated from the federal budget for this purpose in 2011. Ten billion rubles is planned to be allocated in 2012, however the amount may increase in the future based on the development process of the stimulus arrangement. However, a wider use of such tools of intergovernmental fiscal relations is exposed to serious risks which will be examined below.

Russian Government Ordinance No. 798, dd. February 18, 2011, “On the Allocation of Grants in 2011 to the Budget of the Constituent Territories of the Russian Federation to Support Measures of Balancing of the Budget of the Constituent Territories of the Russian Federation Which Achieved Best Results in Enhancing regional taxable capacity” formalized the method of resulting figure calculation and the mechanism of allocation of such stimulus grants. According to this document, a final comprehensive measurement which takes account of economic performance results over the last three year, is to be made to measure the performance of each region. In addition, this comprehensive measurement includes the performance results of the constituent territories of the Russian Federation on the basis of six economic performance indicators which are grouped into three segments: investments, taxation, industrial output. Two economic performance indicators are to be calculated for each segment so that each segment be measured both in terms of dynamics and value. As a result, both re-

¹ Edict of the President of the Russian Federation No. 825, dd. 28.06.2007 “On the Measurement of Effectiveness of Executive Government Bodies of the Constituent Territories of the Russian Federation” (as revised on 28.04.2008 No. 606).

gions with a low value but high growth rates and those with a high value but without pronounced dynamics may equally be qualified for federal support.

It should be emphasized that according to the Ordinance, all economic performance indicators which are considered for allocation of stimulus grants, are to be calculated without regard to the regions' financial and economic performance results in the industries relating to mineral production. This condition was imposed by the federal government bodies even before February 2011, when the idea of allocation of such grants was advanced, however the focus was originally placed on the oil and gas sector rather than the entire extractive industry¹.

A total of three Draft Ordinances of the Russian Government were considered over six months, which differed mostly in the expression of specific economic performance indicators while the list itself remained unchanged. The only thing that should be emphasized is the Ministry of Economic Development and Trade's initiative to widen the scope of assessment, which suggested that the innovation production segment should be assessed as well (in addition to the aforesaid three segments). The following parameters were selected as indicators: level and growth rate of innovative goods, works, services for all types of economic activity. However, this idea failed to receive the required support. A potential reason is that the notion of "*Innovative goods, works and services*" is not well-defined in the federal legislation², which might result in incorrect statistics from both organizations and enterprises and government bodies of the constituent territories of the Russian Federation.

A total of 20 Russian regions received stimulus grants in 2011. Financial support varied within a range of Rb 206,8m to Rb 2bn on the basis of the results obtained through the final comprehensive measurement. The Kaluga Region was ranked first, which managed to be qualified for 20% of total stimulus grants. The Tyumen Region was ranked second and received a significant amount of budget funds (Rb 1,9bn or 19.1% of total), which is a historical recipient of grants for fiscal capacity equalization, as against the Kaluga Region. For example, the Tyumen Region's fiscal capacity stood at 2,347 after Moscow and St. Petersburg in 2011³. The Tyumen Region's consolidated budget tax and non-tax revenues totaled Rb 147,9bn, aggregate income Rb 184,7bn at year-end. Comparing these figures with the amount of allocated grants, proves that this amount is unlikely to have any effect whatsoever on the regional government bodies' goal-setting. Other 18 winners received less than Rb 1bn. In addition, it should be emphasized that a total of 13 constituent territories of the Russian Federation received no grants for equalization in 2011, eight of which received the foregoing stimulus grants at the end of the year. Therefore, such grants can hardly be regarded as a serious stimulus instrument. Allocation of stimulus grants within the framework of the applicable arrangement results more likely in dispersion of a part of the federal budget funds.

As noted above, such stimulus tools of intergovernmental fiscal relations are not regarded as novelty for the practice in Russia. Since 2007, the Ministry of Regional Development of Russia has been measuring the effectiveness of executive branches of the government of the constituent territories of the Russian Federation, which serves as a framework for allocation of grants to most "efficient" regions (based on their performance measured in 2010, 10 con-

¹ <http://www.minfin.ru/ru/press/speech/index.php?pg4=13&id4=12089> – based on A. G. Siluanov's interviews to in agencies at the 8th Krasnoyarsk Economic Forum.

² http://www.gks.ru/free_doc/new_site/business/nauka/minnov3.htm – Rosstat defines this notion as products manufactured by applying various types of technological innovations in the accounting year.

³ According to the Method for allocation of grants for fiscal capacity equalization of the constituent territories of the Russian Federation for 2011.

stituent territories of the Russian Federation received grants within a range of Rb 63m to Rb 116m in 2011). The experience gained over the previous periods shows that performance measurement of government bodies is a challenge. A monitoring of 329 parameters is currently under way, which is subject to annual changes in methods. For example, in 2007–2008, the regions were ranked on the basis of an effectiveness achieved by regional government bodies. As a result, a group of 10 regions was formed, whose composition remained unchanged for two years. Later, in 2009, a decision was made to measure the effectiveness of regional government bodies through the dynamics of indicators. Such an approach also failed to stand up for criticism, and from 2010 they started measure the effectiveness on a comprehensive basis, i.e. both in terms of dynamics and level. Today, the Ministry of Regional Development of Russia highlights the following top-priority lines in the development of methodology: reducing the number of applicable indicators; taking more account of regional specifics; providing a more flexible approach towards materiality of factors which have an effect on the comprehensive assessment; enhancing ways of encouragement of the regions¹.

The developers of the method of measurement of the effectiveness of regions which have achieved best results in increasing taxable capacity, appreciated the weaknesses of the method of the Ministry of Regional Development of Russia. However, federal government bodies may face the same problem in using this method, namely it is impossible within the framework of a specific method to take account of all the specifics of a parameter to measure (taxable capacity in this context). As a result, efforts in making the most adequate measurement would result in increased number of indicators in the method thus making it overloaded, complex and non-transparent.

The method of the Ministry of Regional Development of Russia employs 329 parameters whereas the taxable capacity measurement method has only six parameters. Both methods basically employ economically objective parameters. However, regardless of the applicable methods of measurement of the performance of regional government bodies, the same results will be obtained annually. Today about 10 constituent territories of the Russian Federation can be highlighted, which eventually will be found in the group of leaders regardless of the activities of certain governors in the field of regional economics. Such regions as Moscow, St. Petersburg, the Republic of Tatarstan, the Tyumen Region, etc., initially had favorable opportunities for a good start in their development, therefore most of other regions would not be able to catch up with them by virtue of objective factors.

In general, both measurement of the effectiveness of executive bodies of the constituent territories of the Russian Federation and measurement of regions which have achieved best results in increasing taxable capacity, have a series of critical weaknesses. *First*, such measurements can't reflect the current status of regional economic policies, because the results of decisions made by government bodies are normally not short-term (e.g., the results of current large investments can be seen in five years), or assessed economic indicators depend little from the decisions made by federal government bodies. *Second*, stimulation through allocation of grants to financially successful constituent territories of the Russian Federation is exposed to extra risks of increasing differentiation among the regions and generating interregional contradictions. In addition, a small amount of allocations with a relatively small number of the constituent territories of the Russian Federation subject to rewards, results in

¹ http://www.minregion.ru/press_office/news/1763.html – The Ministry of Regional Development of the Russian Federation.

dispersion of budget funds. This arrangement can't have a significant effect on the creation of priorities for regional government bodies. *Third*, the federal government bodies' efforts in improving a specific method would result in making constant updates thereto thereby preventing the regions from defining correct priorities in the long-terms period.

It should be emphasized that the practice of financial support to the regions on the basis of their economic and financial performance is quite disputable. For example, to obtain more reliable measurements of the performance of government bodies, the system of indicators would be widened. More indicators will result in distortion of the real system of goal-setting on the side of government bodies of the constituent territories of the Russian Federation, which would replace the performance-based work with the indicator-based work. As a consequence, regional government bodies would tend to achieve currently high indicators (better vs. the previous period) without actually working on long-term strategic development plans. It should be emphasized that the aforesaid effects are similar and result from efforts to introduce different systems of result-based budgeting in the public sector both at the government level and at the level of certain ministries and departments¹. To reduce the likelihood of facing the aforesaid issues, it is necessary to give up financing of the constituent territories of the Russian Federation on the basis of their economic and financial performance results, but keep up enhancing the measurement systems themselves. The measurement system is needed to build up a data bank which allows regional processes to be detected in terms of different aspects of regional development for the purpose of identifying, disseminating and applying the best regional practice among the constituent territories of the Russian Federation. Furthermore, it should be noted that revival of the institution of direct elections and early resignation of governors may become the best stimulus and measurement of the performance of regional government bodies, including taxable capacity improvement.

2.3.4. Establishing road funds of the constituent territories of the Russian Federation in 2012

Under Federal Law No. 68-FZ, dd. April 6, 2011, "On the Amendments to the Budget Code of the Russian Federation and the Selected Legal Acts of the Russian Federation", a provision on the establishment of road funds at all tiers of authority was set up for the purpose of financing road activities with regard to public motor roads from 2012². To observe the federal legislation requirements, each region had to develop till January 1, 2012 a regulatory act providing for the establishment of the road fund of a constituent territory of the Russian Federation³. In addition, regional government bodies had to approve a procedure for financing and use of road fund budget allocations as well as update their regional long-term programs on road facilities (their parameters were to be brought in accordance with the amounts of financing from the road fund of a constituent territory of the Russian Federation). Pursuant to

¹ For details refer to, e.g., de Bruin H. Performance-Based Management in the Public Sector. M.: The Institute for Complex Strategic Studies, 2005.

² The Russian legislation requires mandatory creation of the Federal Road Fund (it was stipulated in 2011 under Federal Law No. 357-FZ, dd. December 13, 2010, "On the Federal Budget for 2011 and Planning Period for 2012 and 2013") as well as road funds of the constituent territories of the Russian Federation, since 2012. In addition, municipal road funds may be created by a decision of the representative body of a municipality.

³ Sixty eight of 83 constituent territories of the Russian Federation adopted special laws on the creation of regional road funds while the other 15 updated their effective regulations for budgetary process.

Clause 4, Article 179.4 of the Budget Code of the Russian Federation, the following revenues are considered as sources of financing of regional road funds:

- revenues from excise duties on motor gasoline, straight-run petrol, diesel fuel, oils for diesel and gasoline (injection) engines manufactured on the territory of the Russian Federation, payable as revenues to the budget of a constituent territory of the Russian Federation;
- transport tax revenues.

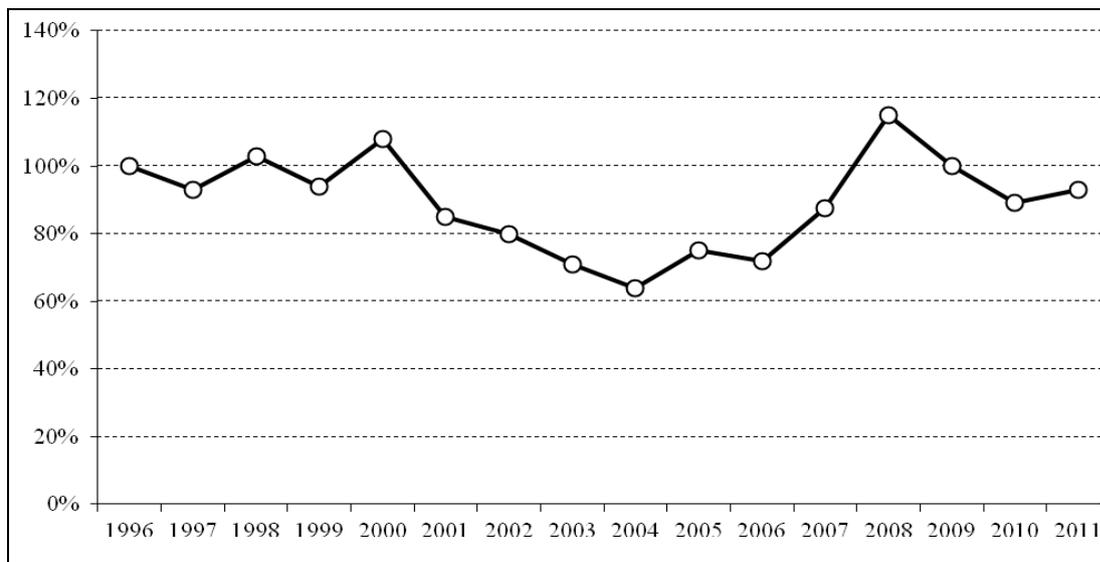
While working on the draft law, some of the regions encountered a problem which was conditioned by the fact that transport tax was included into the sources of financing of the road fund of a constituent territory of the Russian Federation. This tax, however, was long ago placed under the jurisdiction of local government bodies. In analyzing Article 179.4 of the Budget Code of the Russian Federation, one may infer that two specified sources of revenues (transport tax and excise duties on oil products) must be mandatory sources of financing of the road fund of the constituent territories of the Russian Federation. This is because under Clause 1, Article 56 of the Budget Code of the Russian Federation transport tax revenues shall be 100% paid to the budget of a constituent territory of the Russian Federation. Moreover, Article 179.4 of the Budget Code of the Russian Federation specifies that the size of a regional road fund shall be established under the budget law of a constituent territory of the Russian Federation for the ensuing fiscal year (the ensuing fiscal year and planning period) in an amount which should be at least equal to the forecast amount of *budget revenues of a constituent territory of the Russian Federation*. This leads to the conclusion that if the transport tax single standard is transferred to municipal budgets, this source will cease to be a regional budget revenue and, consequently, may not be a source of financing of the road fund of a constituent territory of the Russian Federation¹. Following are the regions in which transport tax was assigned to the municipal level: the Vladimir Region, the Voronezh Region, the Kaluga Region, the Lipetsk Region, the Vologda Region, the Krasnodar Territory, the Orenburg Region, the Perm Territory, Khanty-Mansi Autonomous Area, the Republic of Tyva, the Republic of Dagestan, the Republic of North Ossetia (Alania), the Stavropol Territory and the Chechen Republic.

As a rule, the decision on assignment of transport tax (in full or in part) from the regional to the municipal level of authority was made to maintain fiscal capacity at a certain level and create additional stimuli to enlarge the tax base in municipalities. The practice shows, however, that regions which initially assigned transport tax to municipalities, included afterwards transport tax as a source of financing of such funds, through amendments to already adopted laws on road funds. Therefore, forced abolition of transport tax single standards since 2012 in a series of Russia's regions can be regarded as an adverse effect of the adopted legal regulations concerning road funds. At the same time, transport tax revenues assigned to municipalities could be sources of financing of municipal road funds (however, local government bodies are only entitled rather than obliged to create road funds).

In general, the idea to revive road funds was initiated by the Government of Russia on the basis of analysis of the situation in the road construction sector over the recent 20 years. Advocates of this idea (above all, the Ministry of Transport of Russia and the Federal Road Agency under the Ministry of Transport of Russia) often provide the following data. In 1991–

¹ <http://bujet.ru/article/153917.php> – Creation of Road Funds: Pros and Cons.

2001¹, when a system of financing of road facilities through road funds was in place, about 6,000 to 7,000 km of roads was constructed annually vs. about 2,000 km after the transfer to budget financing. It should be noted that road funds were abolished basically because of a great deal of corruption schemes and reports on improper use by government bodies of accumulated financial resources. Refusal of this type of financing was a logical stage in enhancing the budget policy. However, advocates of road fund revival believe that in spite of a great deal of road funds' inherited problems, volumes of construction and financing of road facilities were bigger when road funds were in place. In general, over the recent 11 years without road funds, expenditures on road facilities have decreased to 0.7% from 1.6% of GDP and even a bigger decline to 0.6% from 2.7% of GDP took place at the regional level. The data presented in *Fig. 20* shows that expenditures on road facilities decreased in real terms after the Federal Road Fund of the Russian Federation was liquidated in 2001. However, these expenditures increased in the period between 2005–2008 and reached the max. value in 2008. Therefore, steady downward trend in expenditures on road facilities was overcome long before road funds were established in 2012. Furthermore, the following should be emphasized. The single undisputable advantage of special purpose road funds against budget financing is a higher degree of “transparency” for car owners – actual taxpayers who form a road fund, because such approach allows them to “see” a price of the actual benefit as motor roads. Financing of road facilities could have been increased without creating special purpose road funds, as partially evident by the “pre-recession” dynamics of the relevant expenditures.



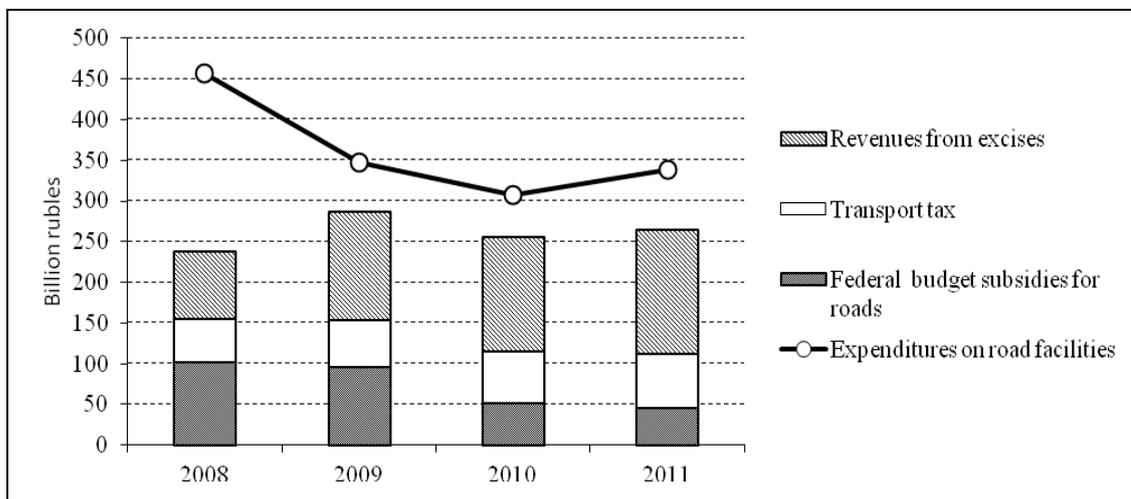
Source: M.Y. Blinkin. Strategy – 2020. Development of the Transport Infrastructure.

Fig. 19. Amounts of financing of road facilities from the budgets at all levels in comparable prices (1996 = 100%)

It was the financial and economic crisis that was basically responsible for interfering with further increase in expenditures on road facilities (after 2008). Subnational budget expenditures on the development of road facilities decreased in real terms by 24.0% in 2009 against

¹ The Federal Road Fund was abolished in 2001. Regional road funds existed until 2003, when they were liquidated upon the abolishment of road tax.

2008 (refer to *Fig. 20*), which was conditioned by both a slump of tax revenues in regional budgets (by 13.5% in nominal terms vs. the percentage reported in 2008) and a decrease in federal subsidies for road facilities (the relevant allocations were cut off within 2009 by 33% against the initial budget projections). Expenditures on road facilities continued to decrease in 2010, but as early as 2011, expenditures on road facilities of the consolidated budget of the constituent territories of the Russian Federation grew up substantially to Rb 424,5bn, a 9.6% growth in real terms against 2010, as the regional economics recovered. It should be noted, however, that the level of related expenditures was much lower in 2011 than the pre-recession level of 2008 (a decrease of 26.1% in real terms). It is hard to make an ambiguous assessment of the decrease in expenditures on road facilities both at the regional and federal levels amid economic recession. International practice proves that increase in expenditures on road construction amid economic recession may be an efficient “counter-recession” channel of expenditures which facilitate (besides direct effect as newly constructed roads) creation of new jobs and recovery growth in industries relating somehow to the road construction sector.



Source: Federal Treasury, Gaidar Institute’s estimates.

Fig. 20. Expenditures on road facilities and principal sources of financing of road funds of the consolidated budget of the constituent territories of the Russian Federation in the period between 2008 and 2011 (in real terms)

The following should be noted through a detail examination of the dynamics of federal budget allocations on the development of road facilities for subnational budgets in 2008-2011, (refer to *Fig. 20*). A share of road subsidies decreased gradually to 12.0% in 2011 from 23.4% in 2008 in the structure of federal budget subsidies. In addition, subsidies for roadway replacement and repair of public motor roads will cease to exist from 2012 at the administrative centers of constituent territories of the Russian Federation and administrative centers of Moscow and Leningrad Regions, as well as subsidies for full repair and repair of the territory and facilities adjacent to blocks of flats, access roads to the territory and facilities adjacent to blocks of flats. Moreover, subsidies on the development of road facilities allocated within the framework of various federal special purpose programs (a 2.4-fold decrease in real terms) de-

creased substantially in the period between 2008–2011. In addition, it should be emphasized that special budget loans to finance road facilities will no longer be extended from 2012¹.

In Russia at large, given the amount of expenditures on road facilities which were allocated in the period between 2008 and 2011 (refer to *Fig. 20*), they would have been covered 64.9% in 2011 from 29.8% in 2008 (had regional road funds existed in that period) by principal taxes – transport tax and taxes on oil products. Considering the fact that Rb 47,6bn of federal subsidies for road facilities is expected to be paid to the regional budgets in 2012², a decrease of Rb 10bn vs. the level of 2011, no substantial increase in expenditures on road facilities is expected in all regions without a visible increase in the relevant taxes. This will be implemented in part. Article 193 of the Tax Code of the Russian Federation provides for a stagewise increase in the rates of excises payable to the road fund of the constituent territories of the Russian Federation. However, the planned increase is unlikely to be sufficient for all regions. Analysis of regional expenditures on road facilities and revenues from transport tax revenues and excises on oil products revealed that creation of road funds in a series of the constituent territories of the Russian Federation may give rise to serious risks in terms of implementing a balanced budget policy. Had regional road funds (with relevant rates) existed in 2011, 53 constituent territories of the Russian Federation would have had to increase their expenditures on road facilities, with more than double increase in 19 of the regions (refer to *Table 24*). As a result, it would have required an involuntary reallocation of cash flows towards the development of road facilities, which would have forced a major revision of other budget expenditures and regional priorities.

Table 24

A breakdown of Russia’s regions by the ratio of the amount of certain excises and transport tax to the amount of expenditures on road facilities in the consolidated budget of a constituent territory of the Russian Federation (net of subsidies)

	2008	2009	2010	2011
More than 200%	0	4	20	19
From 150% to 200%	1	4	10	18
From 100% to 150%	2	22	14	16
From 75% to 100%	9	14	16	8
From 50% to 75%	28	19	6	8
From 25% to 50%	24	13	13	6
Less than 25%	19	7	4	8

Source: Federal Treasury, Gaidar Institute’s estimates.

As noted above, only 26 of 83 regions showed consolidated regional budget surplus at year-end 2011. Creation of road funds may result in growth in total amount of regional budget expenditures and the need to look for extra reserves to generate budget revenues or reduce financing of other important items, namely healthcare or education. As a result, one may detect some “tricks” concealed by the government bodies of certain constituent territories of the Russian Federation in the adopted regional laws on road funds. For instance, the government bodies of the Republic of Khakassia updated the standards for payments by source of financ-

¹ Russian Government Ordinance No. 1062, dd. December 18, 2010, “On the Approval of Rules for the Extension (Use, Repayment) of Federal Budget Loans to the Budget of the Constituent Territories of the Russian Federation for 2012” (as revised on 30.12.2011).

² Now it includes subsidies for road facilities only within the frameworks of a federal special purpose program.

ing of the road fund¹. It was established that 60% for revenues from excises on oil products were to be paid to the budget the Republic of Khakassia, while 40% to the regional budget and allocated to other items which have nothing to do with road facilities.

It should be emphasized that regions which have insufficient funds to finance the road fund and road facilities are entitled to special subsidies under Russian Government Ordinance No. 293, dd. April 18, 2011 “On the Amendments to the Federal Special Purpose Program “The Development of Transport System of Russia (for the period of 2010–2015)”. However, these subsidies only can be allocated to co-finance property assets designed to increase the number of rural settlements which have a year-round access to public hard-top motor roads, as well as regional and municipal property assets of national or regional importance being under construction (reconstruction) in pursuance of regulations and orders issued by the President and the Government of the Russian Federation.

In spite of ambiguous nature of creation of road funds in the Russian Federation, such funds have long been existing in many foreign countries. Furthermore, the international practice classifies all road funds into first generation road funds and second generation road funds. First generation road funds are a budget form, as a budget-funded entity or, like in Russia, funded from the budget of a government authority. Second generation road funds may have founders represented by the state or social agencies, organizations of road users which may provide an extra control of spending and take part in discussions of projects. International experience shows that first generation road funds lack of effectiveness to be able to stepwisely develop the road construction sector. However, road funds in Russia are currently based on this form. More questions arise with regard to sources of financing of road funds. Expenditures on road facilities could be ‘linked tighter’ to revenues from car owners by introducing a motor road toll (i.e. imposing a charge on road users rather than a tax). Furthermore, advanced technologies allow administration costs to be reduced by using GPS navigation technologies intended to accurately measure the distance covered by a specific car driver over a certain period of time.

In general, the following should be noted. Creation of special purpose road funds results in bigger amount of administration costs against budget financing, lower degree of transparency in spending, poor flexibility of the budgetary process. In addition, creation of road funds may have a heavy impact on the balancing of the consolidated budget of the constituent territories of the Russian Federation in 2012. Should funds’ revenues undergo substantial reallocation, the regions would have to either reduce their expenditures or increase fundraising, or wait for support from the federal budget.

2.3.5. The Federal Law “On the Federal Budget for 2012 and the Planning Period of 2013 and 2014” with regard to allocation of interbudget transfers to other levels of the budget system

Federal Law No. 371-FZ, dd. November 30, 2011, “On the Federal Budget for 2012 and for the Planning Period of 2013 and 2014” provides for a total of Rb 1275,0bn of federal budget transfers allocated to the budget of the constituent territories of the Russian Federation, a decrease in nominal terms of 13.4% vs. the year-end 2011. The following types of transfers are to be reduced in 2012: a decrease of 11.5% for grants, 24.1% for subventions,

¹ Law of the Republic of Khakassia No. 93-ZRX, dd. 8.11.2011, “On the Road Fund of the Republic of Khakassia”.

42.4% for other interbudget transfers. The decrease was related to both allocation of large amounts of transfers to the regions as part of the governmental counter-recession program, which was almost completed in 2011, and reallocation of spending powers between the federal center and the regions as a result of the transfer of powers of financial provision of the police force from 2012. On the contrary, from 2012 subsidies are planned to see a small increase of 0.5% in the amount of financing against the level of 2011.

The amount of **grants** in 2012, as noted above, must be reduced in nominal terms by 11.5%, to Rb 498,9bn from Rb 563,5bn (in 2011). This dynamics is maintained through the planned reduction of 40.9%, to Rb 91,2bn in 2012 from Rb 154,3bn in 2011 of grants for the provision of support to measures of budget balancing. During 2012, however, the amount of this type of grants is likely to increase like in 2011 (the initial amount totaled Rb 115,6bn, i.e. an increase of Rb 38,7bn or by 25.0% took place within the fiscal year). It should be noted that allocation of grants for budget balancing still remains one of the least transparent tools of intergovernmental fiscal relations. The following expenditure items specified in the Federal Law “On the Federal Budget for the Period of 2012–2014” (which are recognized as a separate entry beyond any methodological framework of allocation of remaining sums of grants for budget balancing) is a good illustration of non-transparency of this arrangement is This refers to the following transfers:

- Rb 26994,1m grants for balancing of the Chechen Republic budget in 2012,
- Rb 1000,0m grant for balancing of the Omsk Region budget (and the same amount in 2013–2014),
- Rb 20000,0m grants to the budget of St. Petersburg for the purpose of increasing the charter capital of OJSC Zapadny Skorostnoi Diametr in 2012 (as well as Rb 20000,0m in 2013, Rb 10709,7m in 2014).

The latter amount allocated to the budget of St. Petersburg arises more questions. Though this is definitely a special purpose transfer, as may be seen by its title, it was allocated in the form of no-purpose transfer, i.e. grants.

The amount of grants for fiscal capacity equalization of the constituent territories of the Russian Federation in 2012–2014 is to be maintained at the level of 2010–2011, i.e. Rb 397,0bn. Therefore, no indexation of the amount of the Fund for Financial Support for Regions (FFSR) is planned within the entire 5-year period, i.e. visible reduction in real terms of the amount of this Fund was actually planned. It is obvious, however, that the need to narrow interregional differences at least remains the same. This issue is related to the effective legislative regulations under which “total amount of grants shall be determined on the need to achieve the minimum degree of estimated fiscal capacity of a constituent territory of the Russian Federation, which shall be determined as an arithmetic mean value of total indicators of the degree of estimated fiscal capacity prior to allocation of grants among the constituent territories which are ranked neither among the 10 constituent territories with the maximum degree of fiscal capacity, nor 10 constituent territories with the lowest degree of fiscal capacity”¹. Furthermore, the FFSR’s size must not be reduced in nominal terms.

In the period between 1994 and 2002, the FFSR’s size was determined as a share of tax revenues in the federal budget (initially, as a share of VAT, a share of all tax revenues, save

¹ Pursuant to paragraph 1 of the Method of Allocation of Grants for Fiscal Capacity Equalization of The Constituent Territories of the Russian Federation approved by Russian Government Ordinance No. 670, dd. November 22, 2004 (as may be amended).

for customs duties, since 1996). In the period between 2003 and 2007, the FFSR's size was determined by multiplying the last year's Fund's size by the inflation rate forecasted for the ensuing fiscal year (consumer price index). This regulation was established in the Budget Code of the Russian Federation in 2005¹. Since actual inflation rate often was equal to or lower than the forecast, this method of measurement of the FFSR's size resulted in a visible decrease in real terms over the period under review. Furthermore, this approach failed to take account of the real need of the regions for fiscal capacity equalization. To overcome this problems, the measurement procedure was changed in 2008. However, a new approach also had some serious weaknesses.

The following arrangement is offered to enhance the measurement procedure:

1) first, the amount of grants should be determined for equalization by using the procedure in effect;

2) if a resulting amount of grants is bigger than that of the preceding year multiplied by a forecast consumer price index, the amount of grants for equalization should be determined based on the following procedure;

3) if the amount is less than the previous year's amount of grants multiplied by the forecast consumer price index, then the amount of grants for equalization for the planning year should be determined by multiplying the amount of grants for the current year by a planned growth in consumer prices;

4) beginning with the 3rd year of application of the new procedure for measurement of the Fund's size, it would be possible to adjust calculation of the size given the difference between actual inflation and budgeted figures.

Such approach will prevent any substantial reduction in real terms of the Fund's size and make, with a certain lag though, adjustment given the difference between actual and forecast inflation. As a result, the proposed method combines the advantages of the effective approach towards measurement of the FFSR's size and the method of indexation of its size in 2003–2007, and a combination of these approaches allows one to a large extent to cope with the weaknesses of the methods severally.

Total amount of **subsidies** is planned to increase to Rb 483,5bn in 2012 from Rb 481,3bn in 2011 or by 0.5% in nominal terms.

It should be noted that no subsidies are provided for several lines of co-financing of regional expenditures in 2012:

- subsidies for roadway replacement and repair of public motor roads at the administrative centers of the constituent territories of the Russian Federation and the administrative centers of the Moscow and Leningrad Regions, as well as subsidies for full repair and repair of the territory and facilities adjacent to blocks of flats, access roads to the territory and facilities adjacent to blocks of flats;
- measures of social support to rehabilitees and persons recognized as victims of political repressions;
- child support in the foster family and home, as well as remuneration payable to the adopting parent.

Complete cessation of co-financing of road facilities in this line was related to the establishment of regional road funds from 2012. The other two lines relate to redivision of powers

¹ In Clause 2, Article 131 of the Budget Code of Russia.

within the framework of a balanced package on assigning of financing of the police force to the federal budget from 2012.

Let us examine in detail the redivision of revenue and spending powers among the federation and the regions within the framework of delegation of financing of the police force under the federal jurisdiction. The following amendments will take effect from 2012:

- federal secondary vocational education institutions and disinfection institutions, as well as the powers to promote employment (save for social benefits to the unemployed) and the powers to pay a lump-sum benefit for adoption of orphan, will be placed under the jurisdiction of the constituent territories of the Russian Federation;
- the state due on vehicle registration (which is currently payable to budgets municipal and urban districts), as well as 60% of revenues from excise duties on alcoholic products with a.b.v. of more than 9% (100% of such excises were payable to the budget of the regions until 2012) will be payable to the federal budget;
- financial aid to child support in foster families and homes, as well as measures of social support to rehabilitees will be covered by exclusively with the budget of the constituent territories of the Russian Federation.

The aforesaid redivision of powers seems to be disputable from the point of view of both the fiscal federalism theory and the practice of intergovernmental fiscal relations in most of the developed countries with multilevel budget systems. First of all, there are doubts regarding the rationale of placing all powers of ensuring public security as part of law enforcement under the jurisdiction of federal branch of power. Police services constitute a local benefit whose primary recipient is, above all, the local community. In addition, international practice shows that financing of the police force normally falls under the jurisdiction of regional/local government bodies, not the central government (United States, Canada, etc.). It should be noted that Paragraph b), Article 72 of the Constitution of the Russian Federation reads that the joint jurisdiction of the Russian Federation and the constituent territories of the Russian Federation includes: "... ensuring the rule of law, law and order, public security ..."; and Paragraph 1, Article 132 thereof reads that "the local self-government bodies shall independently ... ensure the protection of public order ...". Therefore, the Constitution of the Russian Federation already laid the ground for law enforcement powers of regional and municipal government bodies. In addition, there are questions regarding the cessation of federal budget co-financing of measures of social support to rehabilitees and persons recognized as victims of political repressions. These categories of persons entitled to benefits emerged by virtue of decisions made in due time by the central government. From this point of view, it would have been more logical to place these powers under the federal jurisdiction. Generalizing the aforesaid, it should be noted that effectiveness of implementation of the proposals within the framework of placing all powers of financing of the police force under the jurisdiction of the federal government is disputable.

In accordance with budget projections, total number of federal budget subsidies allocated to the budget of the constituent territories of the Russian Federation must decrease to 94 in 2012 from 105 in 2011 and then keep decreasing gradually to 70 in 2013 and 62 in 2014. In general, this trend should be regarded as positive. The effective system of large number of odd subsidies with the amount being less than (or slightly more than) Rb 1bn for some items is responsible for a visibly lower degree of effectiveness and transparency of the Russia's system of intergovernmental fiscal relations, above all, in terms of restricting the freedom of decision-making on the side of regional government bodies amid non-conformity of federal and

regional priorities in some cases. However, the proposed decrease in the number of subsidies seems to be insufficient.

It should be noted that transition to a result-oriented method of formation of the federal budget creates certain obstacles on creating an intersectoral consolidated (block-based) subsidies. Even this fact, however, fails to explain 62 subsidies planned for 2014. Russian Government Ordinance No. 1950-r, dd. November 11, 2010, approved a list of 40 public programs of the Russian Federation (as amended and updated). These programs cover more than 97% of the federal budget expenditures in 2012–2014. It is also obvious that not every program provides for federal budget co-financing of regional expenditures, simply because relevant powers fall exclusively under the jurisdiction of the federal government. This refers to such programs as “Russia’s Space Activity” (No. 21), “Development of the Nuclear Power Generation Complex” (No. 22), “National Defense Capability” (No. 31), “Federal Property Management” (No. 37), “Foreign Policy” (No. 40), etc. Therefore, one may say that the number of subsidies planned for 2014 is twice as much as the number of public programs. The aforesaid proves that the proposed measures of streamlining the system of subsidies in the Russian Federation are insufficient.

Total amount of **subventions** is planned to decrease in nominal terms by 24.1%, to Rb 256,0bn in 2012 from Rb 337,5bn in 2011. Again, the decrease is conditioned mainly by redivision of powers among the federal center and the regions due to the fact that the police force will be financed by the federal budget from 2012. As noted above, a part of the powers will be placed under the regional jurisdiction (lump-sum benefit payable for any type of adoption of children with are deprived of parental care; promotion of employment, save for unemployment benefits). In addition, in 2012, no subventions will be allocated for exercising powers of preparation and carrying out statistic censuses, because relevant measures have been completed.

Total amount of **other interbudget transfers** must be reduced to Rb 36,5bn in 2012 from Rb 63,4bn in 2011, or by 42.4% in nominal terms, mostly due to the cessation of allocation of interbudget transfers providing an increase, which is equal to that in the Ministry of the Interior of Russia, in the money allowance payable to the personnel and wages of the employees of public security police units (the amount of this transfer accounted almost 35% of the total amount of other interbudget transfers allocated in 2011).

The following regulations stipulated in the Federal Law "On the Federal Budget for 2012 and the Planning Period of 2013 and 2014" should be noted. *First*, an increase in the cost of budget loans (Clause 2, Article 13 thereof) from 1/2 to 2/3 of a refinancing rate quoted by the Central Bank of the Russian Federation (save for financing of measures relating to natural and man-made disaster management). *Second*, a new regulation appeared, under which transfers can be allocated exclusively pursuant to legal acts issued by the Government of the Russian Federation rather than federal executive bodies (Clause 2, Article 12 thereof). These changes can be regarded as positive and improving the effectiveness of the effective system of intergovernmental fiscal relations. It should be noted, however, that the second regulation must, strictly speaking, be applicable to the Budget Code of the Russian Federation on a long-term basis.

In general, it should be noted that the parameters of the Federal Law "On the Federal Budget for 2012 and the Planning Period of 2013 and 2014" with regard to intergovernmental fiscal relations with the constituent territories of the Russian Federation give rise to a series of serious questions in terms of enhancing the effectiveness of the Russian’s system of federalism.

