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The review provides a detailed analysis of main trends in Russia's economy in 2012. 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.

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### Russia's Intergovernmental Relations and Subnational Finance in 2012

#### Subnational budgets in 2012

Major trends in the relationships between different levels of government are reflected in the structure of the revenues and expenditures of the consolidated budget of the Russian Federation. *Table 17* presents data showing the share of tax revenues and expenses of the subjects of the Russian Federation in the relevant indices of the consolidated budget of Russia<sup>1</sup>. It is obvious that the trend to reduce the share of subnational tax revenues, set in 2011 in the consolidated budget of Russia, continued in 2012. This trend is associated with a combination of high energy prices, determining the increased income of the federal budget and low economic growth rates which adversely affect the amount of income tax and personal income tax (the main revenue sources of subnational budgets).

*Table 18*

#### The share of particular indicators of subnational budgets in the consolidated budget of Russia between 1997–2012, in % terms

|  | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Tax revenues   | 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 | 32.9 |
| Tax revenues excluding re-source payments and customs duties | 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 | 55.7 |
| Expenditures   | 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 | 49.3 |

*Source:* Federal Treasury, estimates of the Gaidar Institute for Economic Policy.

The decreased share of tax revenues in the subnational budgets is mainly determined by the very low income tax growth rate (as a result, there was even a decrease of 3.7% in real terms, see below) due to the deceleration of Russian economic growth (real GDP growth declined from 4.3% in 2011 to 3.4% in 2012). At the same time, the share of expenditures of subnational budgets in the consolidated budget expenditure of the Russian Federation continued to increase from 46.5% in 2011 to 49.3% in 2012, which was slightly higher than the corresponding pre-crisis indicator value (by 0.1 percentage point as compared to 2008). As a result, the vertical imbalance which had markedly declined in 2009 - 2010 was increasing during 2011 - 2012 with the simultaneous decrease of the oil and gas revenues of the federal budget and a rising scale of anti-recessionary expenditure at the federal level. Thus, we can say that by the end of 2012, the relations between the basic parameters of the federal and subnational budgets had returned to pre-crisis values. However, the sharp deceleration in the growth of income tax revenues in 2012 raises serious concerns and may lead to a continued fall in the

<sup>1</sup> The detailed analysis of the structure of some indicators of subnational budgets in the consolidated budget of Russia in 1996-2011 see in "The Russian economy in 2011. Trends and Prospects" (Issue 33) - Moscow: Gaidar Institute, 2012, pp. 71-73.

share of tax revenues in the subnational budgets in the consolidated budget of Russia in the future.

Below we consider the situation for the income part of the subnational budgets in more detail. The performance of the main components of the consolidated revenues of the RF subjects is shown in *Table 19*.

*Table 19*

**Performance of the consolidated revenues of RF subjects  
in 2008–2012**

|                                 | Revenues (in nominal terms), RUR billion |              |              |              |              | Real increase, % |               |               |               |               |
|---------------------------------|--|--------------|--------------|--------------|--------------|------------------|---------------|---------------|---------------|---------------|
|                                 | 2008                                     | 2009         | 2010         | 2011         | 2012         | 2009/<br>2008    | 2010/<br>2009 | 2011/<br>2010 | 2012/<br>2011 | 2012/<br>2008 |
| <b>Total revenues</b>           | <b>6,196</b>                             | <b>5,924</b> | <b>6,537</b> | <b>7,644</b> | <b>8,064</b> | <b>-12.1</b>     | <b>1.4</b>    | <b>10.2</b>   | <b>-1.0</b>   | <b>-2.8</b>   |
| <b>Tax and non-tax revenues</b> | <b>4,912</b>                             | <b>4,243</b> | <b>4,980</b> | <b>5,827</b> | <b>6,385</b> | <b>-20.6</b>     | <b>7.9</b>    | <b>10.3</b>   | <b>2.8</b>    | <b>-2.9</b>   |
| Incl. tax revenues              | 4,384                                    | 3,792        | 4,520        | 5,273        | 5,800        | -20.5            | 9.6           | 10.0          | 3.2           | -1.2          |
| Income tax                      | 1,752                                    | 1,069        | 1,520        | 1,928        | 1,980        | -43.9            | 30.6          | 19.6          | -3.7          | -15.6         |
| Personal income tax             | 1,666                                    | 1,665        | 1,790        | 1,996        | 2,261        | -8.1             | -1.2          | 5.1           | 6.3           | 1.4           |
| Lump sum taxes                  | 161                                      | 152          | 179          | 215          | 272          | -13.6            | 8.5           | 13.4          | 18.4          | 25.9          |
| Property taxes                  | 493                                      | 570          | 628          | 678          | 785          | 6.1              | 1.4           | 1.7           | 8.7           | 18.9          |
| Excise taxes                    | 189                                      | 246          | 327          | 372          | 442          | 19.2             | 22.5          | 7.1           | 11.4          | 74.2          |
| <b>Transfers</b>                | <b>1,131</b>                             | <b>1,486</b> | <b>1,398</b> | <b>1,644</b> | <b>1,624</b> | <b>20.7</b>      | <b>-13.5</b>  | <b>10.8</b>   | <b>-7.3</b>   | <b>7.2</b>    |
| <b>Other revenues</b>           | <b>153</b>                               | <b>195</b>   | <b>159</b>   | <b>173</b>   | <b>56</b>    | <b>17.4</b>      | <b>-25.1</b>  | <b>2.5</b>    | <b>-69.7</b>  | <b>-72.7</b>  |

*Source:* Federal Treasury, estimates of the Gaidar Institute for Economic Policy

In general, in 2012 revenues of the consolidated budgets of the subjects of the Russian Federation increased by 5.5% to the level of 2011 in nominal terms. However, if we consider the subnational budgetary income in real terms, the data in *Table 19* shows that in 2012 (for the first time since 2009) total revenues reduced by 1%, while the tax and non-tax revenues increased by 2.8%. The main reason for the reduction of total revenues was the reduced amount of federal transfers. Thus, while in 2011 the amount of allocated inter-budget transfers was RUR 1,644 billion, in 2012 it reduced by RUR 20 billion and amounted to RUR 1,624 billion. (see the *next section* for details).

Analysing the tax revenues separately, it should be noted that they grew by 3.2% in real terms (in 2012 as compared to 2011). However, the performance of the two main taxes - income tax and personal income tax (68.5% of tax revenues) has been mixed. While personal income tax revenues for the period in question increased by 6.3% in real terms, income tax, by contrast, decreased by 3.7%. Accordingly, there have been significant changes in the structure of the tax revenues of subnational budgets: in 2011 the share of personal income tax accounted for 37.8% of total tax revenues, while income tax accounted for 36.6%; in 2012, the amounts were 43.2% and 25.3%, respectively. It should be noted that only income tax revenues did not reach the pre-crisis level: the 2012 decline compared to 2008 was 15.6% in real terms (though the regions have additionally received 0.5 percentage points of the income tax rate since 2009). As a result, the significant reduction in income tax revenues did not allow the subnational budgetary tax revenues for 2012 to reach the 2008 pre-crisis level (a decrease of 1.2% in real terms). The performance of the other tax revenues of the subnational budgets has been more favourable. The highest increase in 2008 - 2012 was recorded in excise revenues – up by 74.2% in real terms, which was mainly associated with the rate indexation. Income taxes on total income and property taxes significantly increased (by 25.9% and 18.9%, respectively).

It is also interesting to consider the revenue pattern of the major types of income payable to the consolidated budget of the Russian regions in terms of GDP (see *Table 20*).

*Table 20*

**Major income revenues of the consolidated budget of Russian regions  
in 2008 – 2012 (% of GDP)**

|   | 2008   | 2009   | 2010   | 2011   | 2012   |
|---|--------|--------|--------|--------|--------|
| <b>Tax revenues, total</b>  | 10.62  | 9.77   | 9.76   | 9.45   | 9.30   |
| Including:  |        |        |        |        |        |
| Corporate income tax  | 4.24   | 2.75   | 3.28   | 3.46   | 3.18   |
| Personal income tax   | 4.04   | 4.29   | 3.87   | 3.58   | 3.63   |
| Excise taxes on goods sold in Russia                              | 0.46   | 0.63   | 0.71   | 0.67   | 0.71   |
| Lump sum taxes  | 0.39   | 0.39   | 0.39   | 0.39   | 0.44   |
| Property taxes  | 1.20   | 1.47   | 1.36   | 1.22   | 1.26   |
| Taxes, fees and regular payments for the use of natural resources | 0.25   | 0.19   | 0.07   | 0.07   | 0.07   |
| <b>Non-tax revenues</b>   | 1.28   | 1.16   | 0.99   | 0.99   | 0.94   |
| <b>Non-repayable receipts</b>                                     | 2.92   | 4.17   | 3.26   | 3.17   | 2.69   |
| <i>For reference: GDP, RUR billion</i>                            | 41,277 | 38,807 | 46,322 | 55,799 | 62,357 |

*Source:* Federal Treasury, estimates of the Gaidar Institute for Economic Policy.

Comparison of the data in *Tables 19* and *20* reveals the differences in performance of individual indicators in real terms and as a share of GDP in 2010 - 2012. Thus, while in real terms, there was an increase of tax revenues in 2010 - 2012 (though very low in 2012), their proportion of GDP showed a steady decline. It is also important to note that despite the increase in personal income revenues in real terms (in 2012 as compared to 2008), the corresponding indicator in terms of GDP is markedly below the pre-crisis value (3.63% and 4.04%). In general, the performance of income tax in terms of GDP corresponds to its performance in real terms, and further underscores the unfavourable situation with these tax revenues (4.24% of GDP in 2008 and 3.18% of GDP in 2012).

Above, we considered the performance of tax revenues at a subnational level in general. Next we shall consider the situation with tax revenues in the Russian regions. *Table 21* shows a grouping of the Russian regions on the basis of changes in tax revenues in general, as well as the income tax and personal income tax revenues in 2012 compared to 2011.

In 2012, sixty eight of the eighty two Russian regions recorded increased tax revenues in their consolidated regional budgets in real terms above the 2011 level. The leaders in terms of growth rates were the Kaluga region (18.8%), the Arkhangelsk region (16.4%), the Republic of Kalmykia (67.5%), the Astrakhan region (23.0%), the Magadan region (16.9%) and the Sakhalin region (19.4%). It should be noted that the particularly high growth rate of tax revenues in the Republic of Kalmykia was provided by an increase in personal income tax (from RUR 1,347 billion in 2011 to RUR 3,775 billion). This significant growth was only determined by the tax payments of a major taxpayer amounting to RUR 2,229 billion. In 2012, the situation with the tax revenues of the subnational budgets in many Russian regions appears to be relatively benign. However, in a number of Russian regions the performance of tax revenues raises some concerns. Among them we should particularly note the Chukotka Autonomous District, where the fall amounted to 4.1% in nominal terms, which (along with the reduction of federal transfers) led to a reduction in total income of 15.7% (transfers and decreases in tax revenues contributed approximately equally to the reduction in total income).

*Table 21*

### Grouping of Russian regions on the basis of changes in the consolidated budget revenues of the region

|                         | The number of regions in which the change of tax revenues |                          |                            |                            |                          |                            |
|-------------------------|---|--------------------------|----------------------------|----------------------------|--------------------------|----------------------------|
|                         | Increased by more than 25%                                | Increased from 10 to 25% | Increased by less than 10% | Decreased by less than 10% | Decreased from 10 to 25% | Decreased by more than 25% |
| <b>In nominal terms</b> |   |                          |                            |                            |                          |                            |
| Total revenues          | 4   | 28                       | 35                         | 14                         | 1                        | 0                          |
| Tax revenues            | 4   | 54                       | 18                         | 5                          | 1                        | 0                          |
| Income tax              | 17  | 27                       | 11                         | 14                         | 7                        | 6                          |
| Personal income tax     | 5   | 69                       | 8                          | 0                          | 0                        | 0                          |
| <b>In real terms</b>    |   |                          |                            |                            |                          |                            |
| Total revenues          | 2   | 5                        | 39                         | 27                         | 9                        | 0                          |
| Tax revenues            | 2   | 18                       | 48                         | 10                         | 4                        | 0                          |
| Income tax              | 6   | 21                       | 23                         | 12                         | 11                       | 9                          |
| Personal income tax     | 3   | 12                       | 66                         | 1                          | 0                        | 0                          |

**Note:** Arkhangelsk Region and Nenets Autonomous District are shown in the calculations as a single entity.

*Source:* Federal Treasury.

Nominal decreases in tax revenues were also observed in the Krasnoyarsk Territory, Murmansk, Belgorod and Kemerovo Regions (within 6%). In all the above regions the share of tax revenue is 60% and it exceeds their total income, so the situation in the public sector in these regions is sensitive to the performance of tax revenues. In contrast, in the Republic of Ingushetia (despite a nominal decrease in tax revenues by 2.2%) it is in the range of 14-16% of the total income of the region making the republican budget dependent not on its own tax revenues, but on the changes in the amount of federal financial support.

In real terms, a fall of tax revenues in 2012 has been recorded in 14 regions already. In addition to the previously mentioned regions of the Russian Federation, this group also includes: the Lipetsk region (-0.7%), Moscow (-1.6%), the Republic of Karelia (-2.6%), St. Petersburg (-4.1%), the Tyumen region (-4.6%), the Khanty-Mansiysk Autonomous District (-2.4%), the Yamal-Nenets Autonomous District (-0.6%) and the Republic of Khakassia (-0.2%)<sup>1</sup>. It should be noted that many of the aforementioned regions are ones with higher or average fiscal capacity.

Stable tax revenues are provided by personal income tax with increased related revenues in real terms in all regions, except in the Vladimir region (-0.9%, while the share of personal income tax in the total income of the region is high enough at about 28%). At the same time, income tax revenues for the period decreased in 21 regions in nominal terms, and in 32 regions of the Russian Federation in real terms. The largest nominal decreases in this tax were observed in the following regions where the share of income tax in their total income exceeds 25%: the Murmansk region (a decrease of 32.7%), the Kemerovo region (-31.6%), the Chukotka Autonomous District (-30.7%), the Belgorod region (-25.0%), Krasnoyarsk Territory (-23.8%), St. Petersburg (-18.0%) and the Lipetsk region (-13.1%).

The performance of income tax revenues both in the whole of Russia and at a regional level, and the reduction of the tax revenues of a number of Russian regions in real terms, including regions with a relatively high fiscal capacity (due largely to the performance of income taxes) is quite worrying, revealing the instability of the recovery of growth in the Russian economy. It is also difficult to suppose the possibility of sustained growth of the revenue base of the regional budgets in the short to medium term. Furthermore, an important negative sig-

<sup>1</sup> The lowest share of tax revenues in total revenues in this group was 57% in the Republic of Karelia (in 2011). In the Republic of Khakassia the indicator was 68.3%, and in other regions it exceeded 70%.

nal is the reduced income of subnational budgets in general. So, 36 regions out of 82 subjects of the Russian Federation recorded a reduced income in real terms and in 9 of them this reduction was between 10% - 25%.

Now let us consider the changes that have occurred in the expenditure component of the consolidated regional budgets of the Russian Federation (see *Table 22*). The total expenditure increased by 8.6% in nominal terms compared to the same period of 2011. However, in real terms, the increase was only 1.9%, and in GDP terms there was a decrease of 0.38 percentage points. The structure of the consolidated budget of the Russian Federation regions has undergone some changes.

*Table 22*

**Expenditures of the consolidated budget of Russian regions in 2011-2012**

|   | % of the total |              | % of GDP     |              | 2012/2011                 |                        |
|---|----------------|--------------|--------------|--------------|---------------------------|------------------------|
|   | 2011           | 2012         | 2011         | 2012         | Increase in nominal terms | Increase in real terms |
|   |                |              |              |              | 2011                      | 2012                   |
| National Issues                           | 6.1            | 6.1          | 0.84         | 0.82         | 8.9                       | 2.1                    |
| National Security and Law Enforcement     | 3.7            | 1.1          | 0.51         | 0.15         | -66.5                     | -68.5                  |
| National economy, incl.:                  | 17.1           | 19.2         | 2.36         | 2.58         | 22.0                      | 14.4                   |
| Agriculture and fisheries                 | 3.0            | 2.9          | 0.41         | 0.39         | 4.0                       | -2.5                   |
| Transportation                            | 2.8            | 3.5          | 0.38         | 0.47         | 39.0                      | 30.4                   |
| Roads (road funds)                        | 5.5            | 7.7          | 0.76         | 1.04         | 52.2                      | 42.8                   |
| Other aspects of the national economy     | 3.6            | 2.9          | 0.50         | 0.39         | -11.9                     | -17.3                  |
| Housing and utilities                     | 12.6           | 10.6         | 1.74         | 1.41         | -9.0                      | -14.7                  |
| Environmental protection                  | 0.3            | 0.3          | 0.04         | 0.03         | -0.3                      | -6.5                   |
| Education, incl.:                         | 22.5           | 24.5         | 3.10         | 3.28         | 18.4                      | 11.1                   |
| Pre-school education                      | 5.1            | 5.6          | 0.70         | 0.74         | 19.0                      | 11.6                   |
| General education                         | 12.8           | 14.1         | 1.76         | 1.89         | 20.0                      | 12.6                   |
| Vocational education                      | 1.1            | 1.5          | 0.14         | 0.20         | 56.3                      | 46.7                   |
| Other aspects of education                | 1.8            | 1.7          | 0.25         | 0.22         | -0.1                      | -6.3                   |
| Culture and film-making                   | 3.1            | 3.1          | 0.42         | 0.41         | 9.5                       | 2.7                    |
| Public health                             | 15.5           | 16.3         | 2.14         | 2.18         | 13.9                      | 6.8                    |
| Social policy                             | 15.5           | 15.3         | 2.14         | 2.04         | 6.9                       | 0.3                    |
| Physical education and sports             | 1.9            | 1.9          | 0.26         | 0.25         | 8.0                       | 1.3                    |
| Mass media                                | 0.4            | 0.5          | 0.06         | 0.06         | 11.6                      | 4.7                    |
| Servicing of the state and municipal debt | 1.0            | 0.9          | 0.14         | 0.12         | -1.5                      | -7.6                   |
| <b>Total expenditure</b>                  | <b>100.0</b>   | <b>100.0</b> | <b>13.76</b> | <b>13.38</b> | <b>8.6</b>                | <b>1.9</b>             |

Source: Federal Treasury.

By analysing the changes in regional budget expenditures in some areas, we can note the following. The greatest decrease in expenditures in 2012 was observed in the section "National Security and Law Enforcement" (-66.5%), which led to a decline in the share of expenditures on this section in the total expenditure from 3.7 to 1.1%. This performance is associated with the transfer of powers on the financial support of the police to Federation level in 2012. A nominal decline was also recorded in one of the major sections "Housing and Utilities" (-9.0%) with its share reduced from 12.6% to 10.6%. It is also important to note a decrease in expenditure on servicing the state and municipal debt by 1.5% in nominal terms against the increase in borrowings in 2012. The lack of growth and even the decrease in expenditure on debt servicing is largely due to the fact that a sharp increase in the growth of borrowing was observed in December, which should result in increased expenditure to be considered in 2013 (for more details on the debt policy see below).

At the same time, a number of major sections showed an increase in expenditure: the "National Economy" (an increase of 14.4% in real terms), "Education" (11.1%) and "Public

Health" (6.8%). In another major section, "Social Policy", the expenditure in real terms has not changed (it increased by only 0.3%).

Particular attention should be paid to the "National Economy" section. The share of expenditure in this area has increased from 17.1% to 19.2% (an increase from 2.36% to 2.58% in GDP terms). It is important to consider the performance not only of the entire section, but also of its separate subsections, as this area of expenditure is quite heterogeneous in contrast to most other areas. Thus, the expenditure on agriculture decreased by 2.5% in real terms, which resulted in some reduction in the share of this expenditure (from 3.0% to 2.9%) of the total expenditure. At the same time such major sub-sections as "Transport" and "Traffic Management" have shown significant growth in real terms, in 2012, these two sections were responsible for 58.6% of the total expenditure of the national economy.

In 2012, expenditures on the "Traffic management" subsection increased by 42.8% in real terms compared to 2011. As a result, the share of this section in the total expenditure increased from 5.5 to 7.7%. The increase in expenditure was associated with the road funds of the RF regions established back in 2011 and replenished primarily by the excise tax on oil products produced in the Russian Federation (increase by 43.5%) and transport tax (increase by 8.3%). As a result, the increased revenues allocated to the road funds of the regions of the Russian Federation led to an increase in maintenance expenditure (from RUR 143.1 billion to RUR 278.5 billion), and to expenditure on the construction of new roads (from RUR 217.3 billion to RUR 262.5 billion). It is also necessary to take into account the increase in federal subsidies for roads from RUR 57.6 billion in 2011 to RUR 98.2 billion in 2012 (for more details on federal transfers see *the next section*).

Expenditure under the "Transport" subsection in 2012 increased by 30.4% in real terms compared to 2011. The share of this section in the total expenditure increased from 2.8 to 3.5%. However, this increase is largely associated with an increase in Moscow expenditure. In 2012, the regional authorities' contributions to the authorised capitals of enterprises amounted to RUR 86.8 billion, accounting for 30.4% of the total expenditure on transport in the whole country. These contributions were made at early stages of the implementation of the Programme of infrastructure development for passenger traffic at the Moscow railway junction in 2012-2020<sup>1</sup>.

Another significant part of subnational expenditure, "Education", increased by 11.1% in 2012 in nominal terms compared to the previous year. The proportion of expenditure in this area increased from 22.5% to 24.5% of the expenditure of the consolidated budget of the regions of the Russian Federation. This increase was primarily associated with an increase in expenditure on general and pre-school education (by 12.6% and 11.6%, respectively). However, we can hardly but note a significant increase in expenditure on the subsection "Vocational Education" - by 46.7% compared to 2011, which led to an increase in the share of this expenditure from 1.1% to 1.5% of the total regional expenditure. This performance was determined by the fact that, in accordance with the order of the Russian Government No. 2413-r dated 29 December 2011, the titles to 706 VE institutions located in 73 regions of Russia were transferred to the regions.

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<sup>1</sup> In addition, in accordance with the Decree of the Government of the Russian Federation No. 2427-r dated 19.12.2012 (On the increase in the authorised capital of Russian Railways OJSC) the authorised capital of Russian Railways OJSC has been increased by RUR 25.9 billion at the expense of the federal budget in order to implement measures for the development of the transport infrastructure of the Moscow region.



In general, in 2012, the consolidated regional budget was reconciled with a deficit of RUR 278 billion, which is RUR 243 billion greater than that for 2011. The total deficit was 3.34% of the total expenditure, which is less than the same indicator in 2009 (5.26%), but higher than in 2010 (1.51%) and 2011 (0.46%). The situation at a regional level is presented in *Table 23*.

*Table 23*

**The result of implementation (deficit/surplus) of consolidated budgets  
for the regions of the Russian Federation in 2008-2012**

|      | The number of regions of the Russian Federation which implemented the budget with |         |
|------|---|---------|
|      | Deficit   | Surplus |
| 2008 | 45  | 39      |
| 2009 | 62  | 21      |
| 2010 | 63  | 20      |
| 2011 | 57  | 26      |
| 2012 | 67  | 16      |

*Source:* Federal Treasury.

The data in *Table 23* suggest that the situation with the deficit of the consolidated budgets of the regions of the Russian Federation in 2012 was worse than in 2011. Whilst in 2011 only 57 subjects reconciled their budgets with deficits, in 2012 their number increased to 67 regions, even more than in 2009 - 2010. It should be noted that in 2012 twenty regions, which had been in surplus in 2011, reconciled their budgets with deficits. Ten of the twenty regions in question showed an increase in expenditure at a rate exceeding the national average (8.7% in nominal terms) due to increases in their total revenues at rates which also exceeded the national average (5.5%). In another 4 regions the expenditure growth rates sufficiently exceeded the national average against a slight increase or decrease in income. At the same time, in 2012 as opposed to 2011, nine regions, by contrast, have reconciled their budgets with a surplus. Thus, we can say that the substantial increase in the number of Russian Federation regions which implemented their budgets with deficits in 2012 is largely determined, not by a significant deterioration of the situation in subnational finance, but rather by a lack of sufficient budgetary discipline by the regional authorities in soft budget constraints specific to the Russian model of federalism.

Based on 2012 results, in ten regions of the RF the consolidated budget deficit exceeded 15% of the tax and non-tax revenues, with the highest value being observed in the Chukotka Autonomous District (46.8%). If we consider the regional budgets (only at a regional level), then the situation is as follows: In twenty of the eighty two regions the deficit exceeded 10% of their revenues, excluding reimbursable transfers. The highest values of this index were recorded in the following regions of Russia: Chukotka Autonomous District (45.7%), Amur Region (20.6%), Krasnodar Territory (18.6%), Pskov Region (18.7), Orel Region (16.5%) and the Yamal-Nenets Autonomous District (16.4%)<sup>1</sup>.

The increase in the number of "deficient" regions and the increase the amounts of budget deficits have led to increased subnational debt borrowings in 2012. The data on the perfor-

<sup>1</sup> Prior to January 1, 2017 the budget deficit may exceed the RF regional limits set in Cl. 2, Art. 92.1 of the Budget Code of the Russian Federation (15% or 10% of revenues excluding non-repayable transfers - depending on the level of subsidisation of the region) within the difference between the received and repaid budget borrowings (Federal Law No. 58-FZ dated 09.04.2009 (as amended on 30.11.2011)).

mance of the public debt of the RF regions and municipal debt in 2011 - 2012 are presented in *Table 24*.

*Table 24*

**The amount of state and municipal debt of subnational budgets  
in 2011–2012**

|   | As at 01.01.11 | As at 01.01.12 |                     | As at 01.01.13 |                     |
|---|----------------|----------------|---------------------|----------------|---------------------|
|   | RUR Billion    | RUR Billion    | Annual increase (%) | RUR Billion    | Annual increase (%) |
| Total for regional budgets  | 1 096.0        | 1 171.8        | 6.9                 | 1 355.0        | 15.6                |
| Total for regional budgets (excluding Moscow and the Moscow Region) | 649.9          | 831.6          | 28.0                | 1 068.7        | 28.5                |
| Total for municipal budgets   | 169.8          | 215.5          | 26.9                | 245.3          | 13.8                |

*Source:* The Ministry of Finance of the Russian Federation.

The table shows that the situation with the amount of debt of the regional and municipal budgets for 2012 generally deteriorated. A significant increase in state and municipal debt was seen in December 2012. Thus, during just one month the national debt increased by 16.4% (by RUR 190.7 billion, from RUR 1,164.2 billion to RUR 1,355.0 billion), and the municipal debt increased by 14.8% (by RUR 31.7 billion, from RUR 213.2 billion to RUR 245.3 billion). During the same period, the amount of loans allocated from the federal budget to regions increased from RUR 88.3 billion to RUR 129.5 billion, while the balance of the budget loans granted to and repaid by the RF regions increased from RUR -12.4 billion only up to RUR +5.2 billion. Thus, the increasing amount of loans is not generally associated with the budgetary borrowings.

As a result, in 2012 the amount of the regional budgetary debt increased by 15.6% (in nominal terms), and, excluding the City of Moscow and the Moscow Region, by 28.5%. Moreover, whilst as at 1 January 2011 the amount of debt in these 2 regions was 40.7% of the total debt of the regional budgets, at 1 January 2012 it amounted to 29.0% and 21.1% at 1 January 2013. In 2012, the debt of Moscow and the Moscow Region decreased by 15.9%. We can say that in 2011 - 2012 the main reduction in public debt was accounted for by Moscow and the Moscow Region whilst the rest of the regions mostly built it up, except for certain periods of decreases in borrowings. Note, however, that the Moscow region, as well as many other regions, increased the amount of its public debt in December 2012 (21.1%), which put the region back from third to second place in terms of debt, trailing only Moscow.

The increase of the debt burdens of the regional budgets is also revealed in the data by regions (see *Table 25*).

*Table 25*

**The performance of the amount if public debt in the regional budgets  
in 2008-2012**

|  |  |
|--|--|
|  | The performance of the amount if public debt in the regional budgets for corresponding periods<br>(in nominal terms) |
|--|--|

|                          | Increase of more than 50% | Increase from 10% to 50% | Increase of less than 10% | No changes | Decrease of more than 10% | Decrease from 10% to 50% | Decrease of more than 50% |
|--------------------------|---------------------------|--------------------------|---------------------------|------------|---------------------------|--------------------------|---------------------------|
| The number of regions in |                           |                          |                           |            |                           |                          |                           |
| 2008                     | 21                        | 26                       | 4                         | 0          | 5                         | 13                       | 9                         |
| 2009                     | 37                        | 20                       | 9                         | 0          | 4                         | 6                        | 2                         |
| 2010                     | 29                        | 28                       | 4                         | 2          | 7                         | 9                        | 0                         |
| 2011                     | 23                        | 33                       | 6                         | 2          | 12                        | 6                        | 0                         |
| 2012                     | 18                        | 36                       | 9                         | 0          | 6                         | 12                       | 1                         |

*Source:* The Ministry of Finance of the Russian Federation.

In 2012, the amount of public debt amount in 63 of the 82 regions of the RF increased, with substantial increases in that amount (over 10%) observed in 54 regions. In 2011, the situation was similar, the public debt during this period increased in 62 regions, and in 56 of those it increased by more than 10%. It should be noted that in 2012 a rate of increase in public debt by more than 50% was observed in 18 regions: Republic of Ingushetia (by 15 times), Yamal-Nenets Autonomous District (by 566.7%), Republic of Tyva (238.1%), Saint Petersburg (149.8%), Murmansk Region (131.8%), Chukotka Autonomous District (111.1%), Kabardino-Balkar Republic (104.4%), in the remaining 11 of the 18 regions the public debt amount for the year increased by between 50% to 100%.

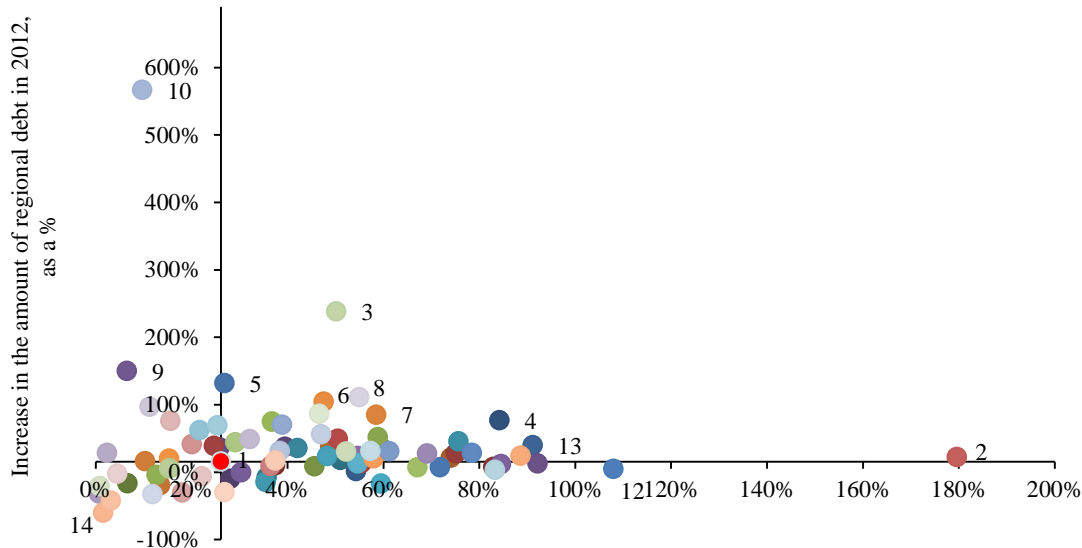
However, of particular concern are the regions of the Russian Federation, which not only significantly increased their amount of debt in 2012, but also significantly increased their debt burden, which is the ratio of the public debt and the level of tax and non-tax revenues of the region of the RF (see *Fig. 17*)<sup>1</sup>. In 2012, the average debt burden of the Russian regions was 26.1%, which is 1% higher than in 2011.

As the figure shows, 37 of the 82 regions of the Russian Federation were in the "troubled sector": the increase in their public debt and their general debt burden was higher than the Russian average. Thus, the public debt of the Belgorod Region during one year only increased by 76.7% providing an 84.2% debt burden. We can also select other regions based on these indicators: Tver Region (21.4% and 74.1%, respectively), Ryazan Region (39.8% and 91.1%), Kaliningrad Region (45.4% and 75.7%), Nizhny Novgorod Region (20.6% and 58.0%), Kemerovo Region (31.3% and 38.4%), Tomsk Region (49.1% and 32.2%), Omsk Region (30.3% and 52.2%). It should be noted that, based on the results of 2012, in two regions the level of debt burden exceeded the amount of tax and non-tax revenues. These are the Republic of North Ossetia-Alania (by 8%) and the Republic of Mordovia (by 79.7%). Whilst in North Ossetia the amount of additional debt granted was 4.6% higher, Mordovia showed a 22.4% increase, which is 6.7 percentage points higher than the national average (15.6%).

In general, we can say that the situation in the field of regional and municipal debts is worsening somewhat, but at the same time most of the regions which are actively increasing the amount of their borrowings are, as yet, far enough from critical values of debt burden. At the same time, there are a few regions where the public debt situation is quite tense. To resolve the situation in a number of regions it will be necessary to reduce the debt. Thus, to lim-

<sup>1</sup> Prior to January 1, 2017 the maximum amount of regional debt (municipal debt) may exceed the limit set in Cl. 2 and 3, Art. 107 of the Budget Code of the Russian Federation (100% of budget revenues, excluding non-repayable payments) within the scope of the regional public debt (municipal debt) in the form of budget borrowings (Federal Law No. 58-FZ dated 09.04.2009 (as amended on 30.11.2011)).

it the debt of five regions, the Russian Ministry of Finance has entered into special agreements, providing for debt reduction over the next three years<sup>1</sup>.



The ratio of the regional debt to tax and non-tax revenues in 2012, as a %

**Note:** 1 - Russia (The intersection of the axes occurs at the point where the debt load and the increase in the amount of debt of the RF regions for 2012 represent the national average values (26.1% and 15.6%, respectively)), 2 - Republic of Mordovia, 3 - Tuva Republic, 4 – Belgorod Region, 5 – Murmansk Region, 6 - Kabardino-Balkar Republic, 7 – Krasnodar Territory, 8 – Chukotka Autonomous District, 10 - Yamal-Nenets Autonomous District, 11 - Republic of Ingushetia, 12 - Republic of North Ossetia – Alania, 13 - Ryazan Region, 14 - Khanty-Mansiysk Autonomous District.

*Source:* Federal Treasury, The Ministry of Finance of the Russian Federation, estimates of the Gaidar Institute for Economic Policy.

*Fig. 17.* Debt load and changes in the amount of regional public debt in 2012 (in %)

In general, summing up the results of the analysis of the main characteristics of the subnational budgets in 2012, the following should be noted. The situation in the field of regional and municipal finance has become more tense: the number of regions that have ended the fiscal year with a deficit has increased; at the end of the year the amount of the borrowings significantly increased. In part, these trends are related to the performance of tax revenues and mainly to the income tax revenues, which decreased in 2012 in real terms. However, as shown above, the regions that have become "unprofitable" in 2012 were the ones which adhered to quite irresponsible budgetary policies, increasing the amount of expenditure at a rate exceeding (and in some cases much higher than) the national average level.

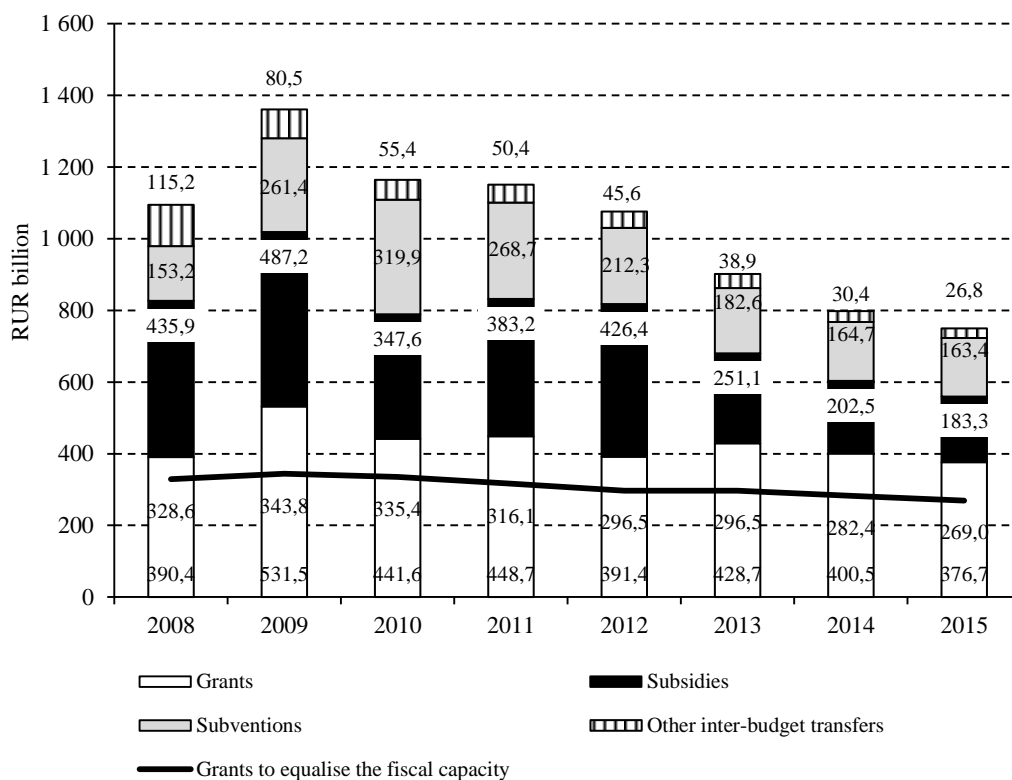
<sup>1</sup> <http://www.minfin.ru/ru/press/speech/index.php?pg56=32&id4=18253> – A.G. Siluanov's statement made during an interview for "Russia 24" on 29.12.2012

### Financial aid from the federal budget

The total amount of funds allocated from the federal budget to subnational budgets in 2012 decreased by 0.4% in nominal terms. However, in real terms, the decrease was already 6.5%. It is possible to speak about a continuing downward trend in the amount of transfers in real terms. Thus, the decrease was 1.2% in 2011 as compared to 2010 and 14.4% in 2010 as compared to 2009. In terms of GDP, the performance was as follows: after a sharp increase in 2009 compared to 2008 (from 2.71% to 3.81% of GDP) during the next three years the total amount of transfers to the regions was gradually decreasing: in 2010 it was 3.0% of GDP, in 2011 it was 2.59% of GDP, in 2012 was 2.31% of GDP.

The surplus of granted and repaid budgetary loans decreased in 2012 to RUR 4.9 billion (from RUR 79.8 billion in 2011). It should be noted that the amount of the federal budget loans allocated in 2012 to the regions slightly increased by RUR 1.2 billion to RUR 129.5 billion. The dramatic decline in the balance was associated with a substantial increase in the amount of budget loans repaid by regions - from RUR 48.6 billion in 2011 to RUR 124.5 billion in 2012.

Let us consider the performance of certain types of federal transfers in more detail (see Fig. 18).



Source: Federal Treasury, Federal Law No. 216-FZ dated 3 December 2012 On the Federal Budget for 2013 and the planning period to 2014 and 2015", estimates of the Gaidar Institute for Economic Policy.

*Fig. 18.* Transfers to regions from the federal budget in 2008-2015 (in 2008 prices)

In real terms, the amount of subsidies, subventions and other inter-budget transfers (other IBT) decreased in 2012 as compared to 2011. Subventions were reduced the most - by 21.0%,

the amount of subsidies decreased by 12.8% and other IBTs by 9.6%. However, if we compare the amounts of these types of transfers in 2012 with their amounts in 2008 (the pre-crisis level), it can be noted that in real terms the subventions increased by 38.6%, subsidies – by 0.3% and other IBTs decreased by 60.4%. In 2012, subsidies increased by 11.3% as compared to 2011 (but the attained level is by 2.2% less than the corresponding value of 2008). It should be noted that in general the 2012 performance was similar to the previous performance in 2011, when there were also reduced subventions and other IBTs and increased subsidies, as compared to 2010. Analysing the Budget Law for 2013 and the planning period 2014-2015, it can be noted that the trend to decrease the amount of transfers will continue. As a result, in 2015 the amount of transfers should be reduced by 31.5% compared to 2008. The proposed amount of grants will be reduced by 3.5%, subsidies by 58%, other IBTs by 76.7%, while subventions will be increased by 6.7% (for more details see Section 2.3.4).

In analysing the process of the allocation of federal budget transfers to regions, it is important to consider the effect of federal aid on the differentiation of the income of the regions, i.e. to assess the levelling properties of financial aid from the federal budget (see *Table 26*).

*Table 26*

**The variation coefficient of revenues of consolidated regional budgets  
(per capita based on the IBE\*) in 2008 - 2012, %**

| Year | Tax revenues | Tax revenues and grants to equalise the fiscal capacity | Tax revenues and the total amount of transfers from the federal budget |
|------|--------------|---|--|
| 2008 | 90.6         | 80.4  | 68.2   |
| 2009 | 78.0         | 66.5  | 51.6   |
| 2010 | 74.2         | 63.9  | 53.6   |
| 2011 | 77.8         | 68.4  | 58.0   |
| 2012 | 72.7         | 64.3  | 55.5   |

\* Index of budget expenditures used by the Russian Ministry of Finance upon the allocation of grants to equalise the fiscal capacity of regions.

*Source:* Federal Treasury, estimates of the Gaidar Institute for Economic Policy.

The data in *Table 26* show that, in 2012, the allocation of subsidies to equalise the fiscal capacity continued to affect the reduction of the inequality in subnational budget income. Note, however, that the extent of this effect has been gradually reducing since 2010. This has largely resulted from the decrease in the share of grants in the total transfers allocated from the federal budget for equalising the fiscal capacity. Whilst in 2008 the share of this type of grants was 30.1%, in 2011 - 2012 it was already 27.6%. One can also note a significant decrease in grants for equalising, from 0.86% in 2010 to 0.64% in 2012 in terms of GDP (0.80% in 2008). The amount of tax revenues in the consolidated budgets of the regions in GDP terms was also decreasing during this period, but at a much slower rate: from 9.76% to 9.30% of GDP (10.62 % in 2008). As a result, in 2012, the variation coefficient of regional revenues, after the allocation of equalising subsidies, decreased by only 8.4 percentage points, whilst in 2008 - 2010 this rate consistently exceeded 10 percentage points. While 27.6% of inter-budget transfers (equalising subsidies) provide exactly the same decrease of the variation coefficient considered as the remaining 72.4% of inter-budget transfers, this indicates the low progressivity of all inter-budget grants, except for the equalising subsidies. Thus, we can speak of the need to increase the share of equalising subsidies in the total alignment of inter-budget transfers.

The above performance of inter-budget transfers allocated from the federal budget has led to certain changes in the structure of transfers in 2008 - 2012 (see *Table 27*).

Table 27

**Transfers to Russian regions from the federal budget in 2008 - 2012**

|   | 2008           |                | 2009           |                | 2010           |                | 2011           |                | 2012           |                |
|---|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
|   | RUR billion    | % of the total | RUR billion    | % of the total | RUR billion    | % of the total | RUR billion    | % of the total | RUR billion    | % of the total |
| <b>Transfers to regions, total</b>                | <b>1 094.7</b> | <b>100.0</b>   | <b>1 480.3</b> | <b>100.0</b>   | <b>1 378.3</b> | <b>100.0</b>   | <b>1 445.6</b> | <b>100.0</b>   | <b>1 440.2</b> | <b>100.0</b>   |
| <b>Subsidies</b>                                  | <b>390.4</b>   | <b>35.7</b>    | <b>578.3</b>   | <b>39.1</b>    | <b>522.7</b>   | <b>37.9</b>    | <b>563.5</b>   | <b>39.0</b>    | <b>524.0</b>   | <b>36.4</b>    |
| Including:  |                |                |                |                |                |                |                |                |                |                |
| Grants to equalise the fiscal capacity            | 328.6          | 30.0           | 374.0          | 25.3           | 397.0          | 28.8           | 397.0          | 27.5           | 397.0          | 27.6           |
| Grants to support measures to balance the budgets | 46             | 4.2            | 191.9          | 13.0           | 105.9          | 7.7            | 154.3          | 10.7           | 117.2          | 8.1            |
| <b>Subsidies</b>                                  | <b>435.9</b>   | <b>39.8</b>    | <b>530.0</b>   | <b>35.8</b>    | <b>411.4</b>   | <b>29.8</b>    | <b>481.3</b>   | <b>33.3</b>    | <b>570.9</b>   | <b>39.6</b>    |
| Including:  |                |                |                |                |                |                |                |                |                |                |
| Subsidies on roads                                | 34.5           | 3.2            | 21.9           | 1.5            | 24.4           | 1.8            | 57.6           | 4.0            | 98.2           | 6.8            |
| Agricultural subsidies                            | 58.4           | 5.3            | 92.5           | 6.2            | 94.8           | 6.9            | 98.5           | 6.8            | 112.8          | 7.8            |
| <b>Subventions</b>                                | <b>153.2</b>   | <b>14.0</b>    | <b>284.4</b>   | <b>19.2</b>    | <b>378.6</b>   | <b>27.5</b>    | <b>337.5</b>   | <b>23.3</b>    | <b>284.2</b>   | <b>19.7</b>    |
| <b>Other inter-budget transfers</b>               | <b>115.2</b>   | <b>10.5</b>    | <b>87.6</b>    | <b>5.9</b>     | <b>65.6</b>    | <b>4.8</b>     | <b>63.4</b>    | <b>4.4</b>     | <b>61.1</b>    | <b>4.2</b>     |

Source: Federal Treasury, estimates of the Gaidar Institute for Economic Policy.

As data Table 27 shows, the amount of *grants* in 2012 decreased as compared to 2011 primarily due to a decrease in the amount of grants to support measures to maintain the budget balance (from RUR 154.3 billion to RUR 117.2 billion). As a result, the share of equalising grants in the total amount of transfers decreased from 10.7% to 8.1%. The share of grants to equalise fiscal capacity has slightly changed (increased by 0.01 percentage points). The total amount of grants in 2012 was 36.4% of the total amount of inter-budget transfers, less than in 2011 by 2.6 percentage points. In general, these changes cannot be unambiguously assessed. On the one hand, the positive effect is the reduction of equalising grants (which are distributed according to the least transparent procedures and criteria), while on the other hand, the equalising grants remained the same during the three consecutive years - RUR 397 billion (the effects of this on performance of the equalising process are mentioned above).

The share of *subventions* in the total transfers decreased from 23.3% in 2011 to 19.7% in 2012. This decrease in subventions was largely associated with the reduction of subventions to exercise authority in the field of employment (reduced by RUR 29.3 billion), the reduction which appeared in 2009 (RUR 7.4 billion), in the subvention to provide housing to veterans of WWII, to commemorate the 65th anniversary of the Victory in the Great Patriotic War, as well as the reduction in the subvention for the purchase of housing by citizens discharged from military service or equivalent persons (reduced by RUR 15.7 billion). The reduction of subventions in the field of employment is associated with the improvement in this area against the continued (albeit slow) growth of the Russian economy. The reduction of two other types of subventions is explained by the gradual implementation of measures to provide housing for the population categories concerned.

By contrast, the share of *subsidies* in the total amount of transfers in 2012, increased by 6.3 percentage points compared to 2011 (from 33.3% to 39.6%). It should be noted that, in general, after the reduction of the share of subsidies in 2009 - 2010, there has been an increase since 2011. So, whilst in 2008 the share of subsidies in the total federal transfers amounted to 39.0%, in 2010 it was 29.8% and in 2012 there was an increase of 0.6 percentage points from the 2008 level to 39.6%.

The main areas of co-financing of the expenditures of subnational budgets in 2012 were:

- The construction and upgrading of roads (17.2% of the total subsidies)<sup>1</sup>;
- Improvement of the regional general education programmes (10.6%);
- State programme for agricultural development and the regulation of agricultural products, raw materials and food markets (9.8%);
- Financial support for additional health care provided by district doctors and paediatricians and general practitioners (family doctors) (3.7%).

The share of *other IBTs* in the total federal transfers continues the downward trend established in 2008. Whilst in 2008 the share of this type of transfer was 10.5%, in 2009 it was 5.9%, in 2010, 4.8%, 2011, 4.4% and in 2012 it was 4.2%.

In general, speaking of the main features of the provision of financial aid to regions from the federal budget in 2012, we can note the following. With some reduction in the total amount of transfers (even in nominal terms), their structure has undergone negative changes. Subsidies came top in the share of the total, amounting to nearly 40%. It is necessary to consider that this type of transfer is still allocated as numerous disparate subsidies, and the process of consolidation is clearly inhibited (for details see *Section 2.3.4*). At the same time, the share of equalising grants (the most transparent and efficient type of transfer) does not change whilst their amount is maintained at the level of the previous year, resulting in a decrease in the scale of reduction of the of regional per capita income differentiation after the allocation of these grants. As a result of the above trends, the transparency of inter-budget relations is reduced and regional governments have less ability to forecast the amount of federal financial aid (as subsidies, along with equalising grants, are the most unpredictable types of transfer).

## Performance assessment of the executive authorities of the Russian Federation

In 2012, the practice of allocating financial resources from the federal budget to the regions of the Russian Federation depending on their results in the field of economy and finance continued<sup>2</sup>. As compared to previous years, it has undergone some changes.

In 2012, the Presidential Decree No. 825 dated June 28, 2007 (On the performance assessment of the executive authorities of the Russian Federation) was repealed. During the few years of its existence the assessment methodology itself had been amended several times. On the one hand, the purpose of regular amendments was to take into account all features of the assessment subject (actions of the public authorities) within one methodology, on the other hand, in practice, this led to an increased number of indicators being used, making it congested, confusing and opaque. In the last edition of this Decree 329 different indicators were in use. The granted amount depended on the size of the integrated assessment and ranged from

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<sup>1</sup> The amounts of these subsidies includes the corresponding expenditures under all federal target programmes.

<sup>2</sup> For more details of the practice of the provision of financial resources depending on the region's results prior to 2012 see Russian Economy in 2011. Trends and prospects. (Issue 33) - Moscow: Gaidar Institute, 2012, pp. 84-88.



RUR 70 million to RUR160 million. Only 10 regions with the best assessment results could qualify.

Replacing the old Presidential Decree, the new one, No. 1199, with the same name (On the performance assessment of the executive authorities of the Russian Federation) was adopted on 21 August 2012. In accordance with this Decree the Resolution of the Government of the Russian Federation No. 1142 dated 3 November 2012 (On measures to implement the Decree of the President of the Russian Federation No. 1199 dated 21 August 2012) was also adopted. It sets the rules on the provision of grants and the executive authorities' assessment methodology. In accordance with the Resolution, a grant from the federal budget can be allocated to the 20 regions that have received the highest ranks under the adjusted comprehensive performance assessment of the executive bodies of the Russian Federation. The performance of regional officials acting in the field of economy, the investment attractiveness of the region, the state and municipal government, and health, education and housing will be assessed. Compared to the previous method in 2007, the new method has significantly reduced the number of indicators used (from 329 to 53)<sup>1</sup>. The assessment will be conducted in two phases. In the first stage a comprehensive assessment is made, taking into account only 12 indicators: life expectancy at birth; population size; the amount of investment in fixed assets (excluding budgetary funds); sales of goods (services) produced by small enterprises, including micro-enterprises and individual entrepreneurs; the amount of tax and non-tax revenues of the consolidated budget of the Russian Federation region, the average annual unemployment rate; the real disposable incomes of the population, the proportion of the total housing floor area commissioned in relation to the total housing floor area; the proportion of graduates of public (municipal), educational institutions who did not pass the unified state exam out of the total number of graduates of public (municipal) educational institutions; mortality (excluding mortality from external causes); an assessment of the activities of the executive authorities of the Russian Federation region by its population; the proportion of children without parental care, including those transferred to non-relatives (to foster care, adoption, under guardianship (custody), foster homes and foster families), or living in any type of state (municipal) institution<sup>2</sup>.

In the second stage the so-called individual performance indicators of the executive authorities of the Russian Federation regions are calculated, and these are used to adjust the estimates of the above 12 indicators. The result is the adjusted comprehensive performance assessment. It is important to note that not all the individual indicators (from the total of 41) are used in the calculations for each region. At this stage, an expert group consisting only of representatives of the federal departments and agencies selects 2 individual targets for each region, to reflect the existing particular problems of the region and the ability to solve them. In 2013, the amount of the grants to the regions (other than inter-budget transfers to promote the best values of the indicators of the performance of the executive authorities) is set at the 2012 level (RUR 1 billion).

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<sup>1</sup> In the original version the new method included 47 indicators. Later, the Physical Culture and Sports Section was added, which contains a number of new indicators.

<sup>2</sup> This indicator was introduced additionally under the RF Government Decree No. 168 dated 28.02.2013.

In addition to the above changes, in 2012, the practice of financing the subnational budgets depending on their results was amended to change another incentive mechanism for the RF regions, which managed to achieve the best results in economic development fund-raising<sup>1</sup>.

Additional grants to regions which achieved the best results on increasing the regional tax capacity were first allocated in 2011: Twenty regions of the Russian Federation received grants in support of measures to balance their budgets, in the amount of RUR 10 billion. Each of the 20 regions has received between RUR 206.8 million to RUR 2 billion of additional undesignated transfers. In 2012, compared to 2011, there were 2 changes introduced in the incentive mechanism for regional authorities. Firstly, the list of grant-receiving regions was extended from 20 to 25. Secondly, changes were made to the assessment methodology by increasing the number of indicators. So, the six existing indicators were supplemented by two money income indicators calculated from the dynamics (growth rate for the last three years) and static (amount per capita). Thirdly, a standard was introduced, which stipulates that the grants to territories and provinces of the regions which include autonomous districts are calculated for the consolidated budget of the territory and the region, including the budgets of the autonomous districts, and credited to the budget of the respective territory or region.

In 2012, despite the increase in the number of regions to 5, there were no increases in the amount of funding. As in 2011, it amounted to RUR 10 billion. As a result, the regions received from RUR 233.6 million to RUR 794.3 million. It is important to note that in 2012 the list included 13 Russian regions, which were already receiving the incentive grants in 2011. For the second consecutive year, the list of regions that have achieved the best results in increasing their regional tax capacity includes: the Republic of Tatarstan (RUR 1,085.0 million as the total amount of grants for two years), Primorsky Territory (RUR 1,001.1 million), Voronezh Region (RUR 683.3 million), Kaluga Region (RUR 2,649.9 million), Leningrad Region (RUR 1,643.9 million), Moscow Region (RUR 627.9 million), Novgorod region (RUR 855.3 million) Omsk Region (RUR 528.3 million), Tula Region (RUR 573.7 million), Tyumen Region (RUR 2,562.9 million), Ulyanovsk Region (RUR 477.6 million), Yaroslavl Region (RUR 487.4 million) and the St. Petersburg (RUR 707.4 million). It should also be noted that in 2012 all those regions with the highest level of fiscal capacity in the country received this type of financial aid, namely the Tyumen Region (RUR 649.9 million), St. Petersburg (RUR 388.5 million) and Moscow (RUR 435.9 million). This seems to be rather a contested decision, especially considering that these amounts represent a small share of the budget of the mentioned regions (for example, in the Tyumen Region and its associated ADs it was 0.12% of the total consolidated budget revenues).

In addition to the mechanisms discussed above for allocating financial resources to regions from the federal budget, depending on their results, in 2012, the Presidential Decree No. 1276 dated 10 September 2012 (On the performance assessment of the heads of federal executive agencies and chief executives (heads of supreme state executive authorities) of the Russian Federation, intended to create a favourable business environment) was also issued. This Decree should be aimed at assessing the performance of the heads of the federal authorities and regions in the relevant field. It should be noted that the public authorities are also assessed under the Presidential Decree No. 579 dated 13 May 2010 (as amended on 14 October 2012)

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<sup>1</sup> Government Decree No. 798 dated 27.09.2011 (as amended on 12.12.2012) "On the distribution of subsidies to support measures to balance the budgets to the Russian regions achieved the best results in the increase of the regional tax capacity".

"On the performance assessment of the executive authorities of the Russian regions, city and municipal districts, local self-government authorities in the field of energy conservation and the improvement of energy efficiency" and Presidential Decree No. 607 dated 28 April 2008 (as amended on 14 October 2012) "On the performance assessment of local self-governing authorities of city and municipal districts".

It must be stressed that the mechanism for funding the regional authorities depending on their results, has a number of inherent disadvantages<sup>1</sup>. *Firstly*, such estimates can not reflect the current state of regional economic policy, as either the results of resolutions adopted by the authorities are long-term (e.g., the results of on-going large investments can be seen only after a number of years) or the assessed economic indicators depend very little on the resolutions made by public authorities. *Secondly*, the promotion, through the mechanism, of the allocation of grants to the financially successful RF regions, can hardly be effective, given the small amount of funds allocated to the relatively large number of regions entitled to premiums. As a result, this mechanism cannot have a significant influence on the priorities of the regional authorities, and only leads to the dissipation of the budget funds. *Thirdly*, the federal government's commitment to improving the individual methodology will lead to constant changes to it, which will not allow the regions to correctly determine their long-term priorities.

In this sense, 2012 has shown that there is a regular extension of the system of indicators in order to obtain a more objective performance assessment of the government. Thus, already in 2012, the methodology for assessing the fiscal capacity had existed for only for one year before it was changed to increase the number of indicators (from 6 to 8). However, increasing the number of indicators by this method will also lead to a distortion of the real goal-setting system on the part of the regional authorities of the Russian Federation, replacing results-oriented work with index-oriented work. As a result, the regional authorities will seek to achieve current high indices (higher than in the previous period) without carrying out the actual work under the long-term strategic development plans. Expansion of the system of indicators makes the assessment complex and confusing, and, as a result, the regional leaders do not understand how they should organise their work to meet the federal government-proposed evaluation system and actually improve the socio-economic situation of their region. The result is the rejection of sophisticated methodologies for assessing all aspects of life in the region (as in the methodology proposed by the Ministry of Regional Development, based on 329 indicators) and the transition to a simpler mechanism, as has happened in 2012 (the decrease in indicators to 14 (12 core and 2 individual ones for each region)). It should be noted that originally (in 2007) the methodology of the Ministry of Regional Development also included dozens of indicators, but over a few years their list has increased by several times, and the methodology dated 3 November 2012 has been increased by six indicators. So, in the future, we can expect its increased complexity, which ultimately will lead, perhaps, to its abolition.

It is important to understand that the above effects are similar to those that result from attempts to introduce different systems of Performance Budgeting in the public sector at the

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<sup>1</sup> For more details see Russian Economy in 2011. Trends and prospects. (Issue 33) - Moscow: Gaidar Institute, 2012, pp. 87–88.

level of government, in general and for individual departments and agencies<sup>1</sup>. In order to reduce the likelihood of the problems described above, we must reject the funding of the RF regions depending on their results, but to improve the assessment systems. The assessment system is required to create a knowledge base for identifying the processes taking place in the region, based on various aspects of regional development. This will enable the identification of the spread and application of regional best practice in other regions of the Russian Federation. It is also important to note that the real renaissance of the institution of the direct election of governors and the possibility of early termination of their powers may be the best incentive and the best performance indicator of the regional authorities.

Federal law of 3 December 2012 No. 216-FZ "On the Federal Budget for 2013 and the planning period to 2014 and 2015" for the allocation of intergovernmental transfers to other levels of the budgetary system

The Federal Law No. 216-FZ dated 3 December 2012 "On the Federal Budget for 2013 and the 2014 and 2015 planning period" implies a gradual reduction of the total amount of transfers allocated to regional budgets from the federal budget in nominal terms as compared to 2012. The overall decrease in the amount of transfers in nominal terms is expected to be 9.8%. First of all, the reduction of the total amount of transfers is related to a reduction of subsidies (by 32.8% in nominal terms in 2013 as compared to 2012).

The planned performance of certain types of inter-budget transfers differs substantially. The budget projections provide for a noticeable growth in **grants** allocated from the federal budget to regions, from RUR 524.0 billion in 2012 to RUR 602.9 billion in 2013 (increased by 15.1% in nominal terms and by 9.0% in real terms). Then, in 2014 - 2015, it is planned to reduce their volumes by 1.6 - 1.7% annually. Note, however, that the marked increase in the amount of grants is primarily achieved by increasing the amount of grants to support measures to balance the budgets of the Russian regions. The growth of this type of transfer is planned at a level of 45.7% in nominal terms and 38.0% in real terms in 2013.

The additional increase in financial aid to Russian regions, by RUR 100.0 billion annually, in the form of grants to support measures to balance their budgets in 2013 - 2015 is associated with the increased expenditure commitments of subnational budgets in the process of implementation of the Presidential Decrees dated 7 May 2012. In addition, the Law provides for the distribution of RUR 60 billion in grants for partial compensation of the additional costs of increasing the wages of public sector employees. It should be noted that the increase in expenditure commitments on wages of public sector employees at a rate exceeding the increased rate of tax and non-tax revenues of the regional budgets introduces risks for the balance of the budget system as a whole, in the face of the uncertainty in the global economy, given that such current expenditure commitments are extremely difficult to reduce. In the case of deterioration of the global conditions, the subnational budget deficits could increase substantially, and this would require a significantly greater amount of additional financial aid to the regions to be provided by the federal government (given that during the crisis market borrowing opportunity would be sharply reduced). It should be borne in mind that the current budget pro-

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<sup>1</sup> For more details see, for example, H. de Bruijn. Management in the public sector. Moscow: Institute for Complex Strategic Studies, 2005.

jections for 2013 already include an increase in the federal budget deficit from 0.06% of GDP in 2012 to 0.78% of GDP in 2013. Thus, we can say that the federal government resolutions have created additional expenditure commitments for subnational budgets which result both a deterioration of condition of the regional budgets in terms of their expenditures and total tax and non-tax revenue proportions, and to increases in the overall risk for the budget system of the Russian Federation.

Examples of opaque mechanisms for providing the equalising grants include the following amounts from the Law on the Federal Budget for 2013 - 2015 to be allocated to a number of regions, which are reflected as a separate line, in fact beyond any methodological framework of distribution of the remaining amounts of equalising grants:

- Grants to support measures to balance the budget of the Chechen Republic in 2013 amounting to RUR 23,555.2 million,
- The grant to the Omsk Region budget to balance the budget in the amount of RUR 1,000.0 million annually during 2013 - 2014,
- Grants to the budget of St. Petersburg to increase the authorised capital of Western High-Speed Diameter JSC, in the amount of RUR 20,000.0 million in 2013 and RUR 10,709.7 million in 2014.

The latter amount allocated to the budget of St. Petersburg raises additional questions. Based on the name of the transfer, it obviously has a special purpose, yet it has been granted in the form of a non-purpose transfer (grant).

The Law we are investigating also provides for some indexation of grants to equalise fiscal capacity (allocated from the Fund for Financial Support of the Regions (FFSR)) in 2013 - 2015 relative to the level of 2012. In 2011 - 2012, the FFSR amount remained at the 2010 level, so the proposed indexation of its amount can be positively evaluated. But the amount of this indexation is ambiguous. An increase in equalising grants is provided only for 2013, at 5.5%, i.e. at the projected rate of inflation. Then, in 2014 - 2015 the FFSR amount will be maintained at the 2013 level. As a result the FFSR amount in 2013 in real terms is 11.1% less when compared to 2010. In 2014 - 2015, if there is no further indexation, the decline in real terms will continue. In this case, the need for financial resources to equalise the fiscal capacity of the RF regions at least does not decrease. Perhaps, in 2013, under the new draft federal budget for 2014 - 2016 the new increased FFSR amount will be determined (again the same for all three years).

In general, the trend to increase the amount of grants and their share in the total amount of inter-budget transfers (it is planned to increase this share from 36.4% in 2012 to 50% in 2014 - 2015) should be appreciated, however, as noted above, this increase is achieved primarily through equalising grants. As a result, it does not lead to a significant increase in the level of transparency of intergovernmental fiscal relations between the federal centre and the regions and does not allow them significantly to improve their financial autonomy (as the distribution of balancing grants is much less transparent, predictable and methodologically sound than the distribution of grants to equalise the fiscal capacity). From this point of view, it would be logical to increase the FFSR by comparable amounts.

In 2013 - 2015 it is planned significantly to reduce the **subsidies**: by 32.8% in nominal terms in 2013 (as compared to the previous year), by 21.3% in 2014 and by 4.3% in 2015. As a result, their share in the total amount of inter-budget transfers should be reduced from 39.6% in 2012 to 24.6% in 2015. It is proposed to reduce the amount of subsidies from the

federal budget in the following areas: housing and utilities (75.0%), public health (54.4%), physical education and sports (33.8%) and the national economy (29.7%). At the same time, it is planned to increase the subsidies for national security and law enforcement (81.1%), environmental protection (374.3%) and social policy (17.0%). Budget estimates provide for the reduction of subsidies from 104 in 2012 to 93 then 81 and 70 types for the years 2013 – 2015 respectively. In general, the trend to decrease the number of grants and their share in the total federal transfers should be assessed as positive. The current system of a large number of separate subsidies, where the total amount in some areas does not exceed (or is barely above) RUR 1 billion significantly reduces the efficiency and transparency of the Russian system of inter-budget relations, mainly in terms of excessive restrictions as regards free decision-making by regional authorities against the discrepancies of federal and regional priorities in some cases (i.e. the federation can not correctly identify what people really need in this or that region). However, the proposed reduction of subsidies is obviously insufficient.

It is important to note that the "Main targets of the budgetary policy for 2013 and the planning period of 2014 and 2015" is to propose "to consolidate the currently applicable subsidies into single ones under the relevant state programmes for each chief administrator of the federal budget." The Order of the Federal Government No. 1950-r dated 11 November 2010 approves a list of 41 state programmes of the Russian Federation (as amended). In this case, each programme provides for one responsible person (federal ministry or agency) and collaborators (federal ministries or agencies). Comparing the number of government programmes and the expected number of subsidies allows us to draw the clear conclusion that more than one subsidy will be allocated under at least some state programmes, which seems to be unnecessary and to over-complicate the system of inter-budget transfers. It should also be borne in mind that not every programme provides for the co-financing of regional expenditures from the federal budget, just because the relevant authority is exclusively assigned to the federation. By this we mean such programmes as "Russia's space activities", "The development of the nuclear power industry," "Ensuring the defence capability, "Foreign policy activities", etc. Thus, we can say that the number of subsidies planned by 2015 exceeds more than 2 times the number of state programmes. It is important to note that the law on the federal budget for 2012 - 2014 provided for a reduction in the number of subsidies down to 70 in 2013 and 62 in 2014, i.e. the plans have been significantly adjusted to increase the number of subsidies. Thus, there is obviously a clear inhibition of the reforming process for the mechanism for allocation of subsidies from the federal budget, which may significantly affect the transparency and efficiency of inter-budgetary relations between the federation and the regions.

In 2013, it is also planned to decrease the amount of **subventions** (by 9.5% in 2013 as compared to 2012) and reduce **other IBTs** (by 9.2% in 2013 as compared to the previous year). Despite the decrease in the total of other IBTs, in 2013 it is planned to allocate significant funds to finance the purchase of diagnostic tools and antiviral drugs for the prevention, detection, monitoring and treatment of persons infected with the human immunodeficiency virus and hepatitis B and C, in the amount of RUR 14 billion (25.2% of the total amount of other inter-budget transfers), as well as other IBTs related to the implementation of activities on the preparation and holding of the 2018 World Cup in the Russian Federation (for the design and construction or renovation of stadia in the amount of RUR 4.9 billion). The latter amounts are lump sums and more related to solving the current economic and social problems, so after 2014 it is proposed to decrease other inter-budget transfers by 17.8% as com-

pared to 2013. In addition, after 2014, the grants and inter-budget transfers for the development and support of the social and physical infrastructure allocated by the federation to the Closed Administrative-Territorial Entities will be consolidated into a single inter-budget transfer in the form of a grant. Thus, a part of the amount of other inter-budget transfers will be redistributed in favour of grants to Closed Administrative-Territorial Entities. As a result, in 2014 - 2015 it is planned to reduce the share of this type of transfer from 4.3% in 2013 to 3.6% in 2015. However, given the budget plan for 2012 and the actual amount of other IBTs for the year, we can forecast that this type of transfer can be significantly changed during the year. Thus, the amount of other IBTs allocated in 2012 was 67.3% higher than had been initially planned.

In general, it should be noted that the parameters of the Federal Law "On the Federal Budget for 2013 and the planning period of 2014 and 2015" raises a number of serious issues in terms of inter-budgetary relations with the Russian regions as regards the improvement of the efficiency of the Russian system of federalism. Firstly, insufficient indexation of balancing grants with a significant increase in the balancing grants themselves does not allow for enhancement of the transparency and predictability of the process of allocation of federal transfers to the regions. Secondly, there is an apparent inhibition of reforming the mechanism of co-financing regional expenditures through the mechanism of allocating subsidies against the adjustment of plans, to reduce their number significantly. In this case, it is unclear how much subsidy will eventually be allocated in 2013 and whether there is a planned significant decrease in the amounts of these transfers.

