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The review provides a detailed analysis of main trends in Russia's economy in 2014. 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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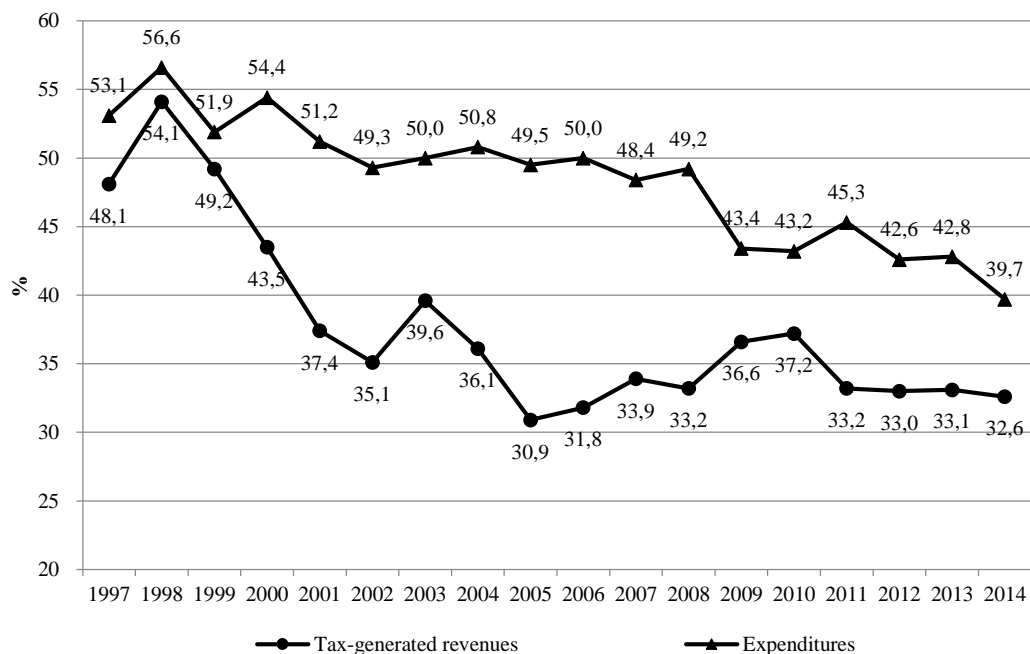
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2.3. Interbudgetary Relations and Subnational Finance

2.3.1. Analysis of the Main Parameters of the Consolidated Budget of Subjects of the Russian Federation

The main trends observable in the relations between different tiers of government authority are reflected by the structure of revenue and expenditure in the consolidated budget of the Russian Federation. *Fig. 17* presents data on the movement of the relative shares of tax-generated revenues and expenditures of subjects of the Russian Federation in Russia's consolidated budget.



Note. No calculations were done for the Crimean Federal District's regions.
Source: RF Federal Treasury; authors' calculations.

Fig. 17. The Share of Subnational Tax-generated Revenues and Expenditures in Russia's Consolidated Budget in 1997–2014

The year 2014 saw a slight shrinkage in the share of tax-generated revenues received by subnational budgets in the consolidated budget of the Russian Federation - from 33.1% in 2013 to 32.6% in 2014. Over the same period, the share of expenditure demonstrated a more notable decline - from 42.8 to 39.7% (less the amount of expenditure for the Crimean Federal District). The shrinkage of the share of subnational budget expenditure in the total consolidated budget expenditure of the Russian Federation can largely be explained by the accelerated growth of federal budget expenditure (by 11.4% in nominal terms). The leaders in growth in the federal budget were the expenditures earmarked for national defense and national economy. Over the

same period, the amount of subnational budget expenditure increased by only 4.6% (less the amount of expenditure for the Crimean Federal District).

Now let us take a closer look at the revenue side of subnational budgets. The movement of the main components of the consolidated budget revenue of subjects of the Russian Federation is shown in *Table 14*.

Table 14

**Consolidated Budget Expenditure of Subjects
of the Russian Federation in 2008–2014**

	Volume of revenue (in nominal terms), bn Rb							Growth in real terms, %				
	2008	2009	2010	2011	2012	2013	2014	2009/ 2008	2010/ 2009	2014/ 2008	2014/ 2009	2014/ 2013
Revenue, total	6,196	5,924	6,537	7,644	8,064	8,165	8,743	-12.1	1.4	-11.2	1.1	-3.9
Tax-generated and non-tax revenues	4,912	4,243	4,980	5,827	6,385	6,588	7,141	-20.6	7.9	-8.5	15.3	-2.7
<i>including tax-generated revenues:</i>	<i>4,384</i>	<i>3,792</i>	<i>4,520</i>	<i>5,273</i>	<i>5,800</i>	<i>5,967</i>	<i>6,461</i>	<i>-20.5</i>	<i>9.6</i>	<i>-7.2</i>	<i>16.7</i>	<i>-2.8</i>
profits tax	1,752	1,069	1,520	1,928	1,980	1,720	1,962	-43.9	30.6	-29.5	25.7	2.4
PIT	1,666	1,665	1,790	1,996	2,261	2,499	2,679	-8.1	-1.2	1.3	10.2	-3.8
taxes on aggregate incomes	161	152	179	215	272	293	314	-13.6	8.5	22.6	42.0	-3.7
taxes on property	493	570	628	678	785	901	955	6.1	1.4	21.9	14.9	-4.8
excises	189	246	327	372	442	491	479	19.2	22.5	59.2	33.6	-12.5
Transfers	1,131	1,486	1,398	1,644	1,624	1,515	1,545	20.7	-13.5	-14.0	-28.8	-8.5
Other revenues	153	195	159	173	56	62	57	17.4	-25.1	-76.3	-79.8	-16.4

Note. No calculations were done for the Crimean Federal District's regions.

Source: RF Federal Treasury; authors' calculations.

As can be seen from the data presented in *Table 14*, in 2014 the amount consolidated budget revenue of subjects of the Russian Federation in 2014 on the whole declined on 2013 - by 3.9% in real terms. The total amount of revenue in real terms in 2014 shrank due to the declining rate of economic growth, and also because the rate of growth (in nominal terms) of the main revenue sources was lagging behind the inflation rate¹. Among all the main sources of revenue in 2014, only the profits tax receipts in real terms displayed a positive rate of growth of 2.4% on the previous year. At the same time, another main source of tax-generated revenues – PIT – moved in the opposite direction, declining in 2014 by 3.8% in real terms. As a result, the structure of tax-generated revenues also changed: the share of profits tax in the total volume of tax-generated revenues increased from 28.8 to 30.2%, while the share of PIT somewhat declined - from 41.9% to 41.3%. Growth of the profits tax receipts can largely be explained by the low base effect of 2013, while even when taken in nominal terms, the revenue volume is below its 2012 level (Rb 1,962bn vs. Rb 1,980bn respectively). With regard to PIT it should be noted that, in 2014, for the first time over several years, the population's real disposable income declined (by 1% on 2013), which was the main reason why the receipts of PIT in 2014 dropped for the first time since 2011 (in real terms).

¹ Thus, while in 2010 Russia's GDP growth rate amounted to 4.5%, and in 2011 – to 4.3%, in 2012 it dropped to 3.4%, in 2013 to 1.3%, and then in 2014 to 0.6%. At the same time, in 2014 the inflation rate amounted to 11.4%, which is its record high for the period under consideration (2010–2014).

We can also note the uneven spread of the receipts of main tax-generated revenues over the course of each year. Thus, the monthly amount of profits tax receipts in October and November 2014 shrank, in nominal terms, by 22.8% and 26.7% respectively on the corresponding periods of 2013; a decline of this index was also observed in January 2014 (-12.7%). In November 2014, a sharp slowdown in the flow of receipts from another major revenue source (PIT). In December the revenue growth index more or less returned to its usual value, which happened due in the main to the profits tax receipts. So, if the situation in the national economy should deteriorate any further, the vector of the main tax receipts (PIT and profits tax) will be persistently negative; however, these taxes largely determine the level of budget revenue in those regions that receive no dotations or only a small amount of dotations (whereas the situation in those RF subjects that are highly dependent on dotations is more strongly dependent on the movement of transfers from the federal budget).

The downward movement of total consolidated budget revenue of RF subjects was also influenced by the movement of receipts of excises on petroleum products, which happened in part due to the introduction of the Customs Union's new technical regulation (on the whole, the amount of excise receipts shrank by 12.5% in real terms).

In 2014, the amount of non-tax revenues remained practically at the same level as over the previous year (a decline in real terms by 1.7%). However, in spite of this decline, the share of that source of revenue in the overall structure of consolidated budget revenue of RF subjects slightly increased – from 7.6% to 7.8%. It must be emphasized in this connection that, while the amount of consolidated budget revenue proper (tax-generated and non-tax) was on the decline, the amount of transfers in 2014 likewise declined, and at a faster rate – by 8.5% in real terms. The movement of transfers from the federal budget is dealt with in more detail in Section 2.3.2.

Here we are going to view more closely the situation with regard to receipts of tax-generated and non-tax revenues in various subjects of the Russian Federation (*Table 15*).

Table 15

**Russia's Regions Grouped in Accordance with the Movement
of Major Tax-generated and Non-tax Revenues in the Consolidated
Budget of Subjects of the Russian Federation**

	Movement of major tax-generated and non-tax revenues in consolidated budgets of RF subjects					
	growth by more than 25%	growth between 10% and 25%	growth by less than 10%	decline by less than 10%	decline between 10% and 25%	decline by more than 25%
in nominal terms						
Tax-generated and non-tax revenues, total	5	9	62	5	1	0
Profits tax	19	15	20	16	11	1
PIT	0	6	74	2	0	0
in real terms						
Tax-generated and non-tax revenues, total	1	5	5	63	8	0
Profits tax	9	12	12	20	25	4
PIT	0	0	2	78	2	0

Note. 1) Arkhangelsk Oblast and Nenets Autonomous Okrug are treated for the purpose of our calculations as one and the same subject of the Russian Federation. 2) No calculations were done for the Crimean Federal District's regions.

Source: RF Federal Treasury; authors' calculations.

As seen from the data presented above, the majority of Russian regions continued to experience difficulties with regard to the availability of subnational budget revenue proper (just

as they did in 2013¹). Thus, in 2014, a decline of subnational budget revenue proper in real terms was observed in 71 regions, and in 63 of these the revenue decline was within 10%. In spite of the general rise in the profits tax receipts on a national scale, in 4 regions the revenues generated by this source dropped by more than 25% in real terms: in Belgorod Oblast (-25.9%), in Kaluga Oblast (-27.7%), in the Republic of Karelia (-25%), and in the Republic of Buryatia (-39.1%). Overall, the amount of profits tax receipts in real terms declined in 49 regions. In the other 33 regions this index displayed growth in real terms, and in 9 RF subjects it increased by more than 25%: in Lipetsk Oblast (28.2%), in Kaliningrad Oblast (57%), in Leningrad Oblast (53.9%), in the Republic of Mordovia (201.9%), in Tyumen Oblast (39.4%), in the Khanty-Mansi Autonomous Okrug (61.2%), in the Republic of Sakha (Yakutia) (42.3%), in Sakhalin Oblast (109.8%), and in Chukotka Autonomous Okrug (59.9%). Due to the increased profits tax receipts, Sakhalin Oblast managed to push up its revenue proper by more than by 25% (55.1%), which represents an exceptional case by comparison with the general situation in this country. As far as PIT receipts are concerned, the majority of regions (78) experienced a decline in the range of 10%. Growth could be observed only in Samara Oblast (0.2%) and Tambov Oblast (2%).

Now let us analyze the changes that occurred in 2014 in the expenditure side of the consolidated budget of subjects of the Russian Federation (*Table 16*). On the whole, the amount of aggregate expenditure declined on 2013 both in real terms (-4.7%), and in terms of share of GDP (by 0.12 pp. - from 13.30 to 13.18%).

Table 16

**Consolidated Budget Expenditure of Subjects
of the Russian Federation in 2013–2014**

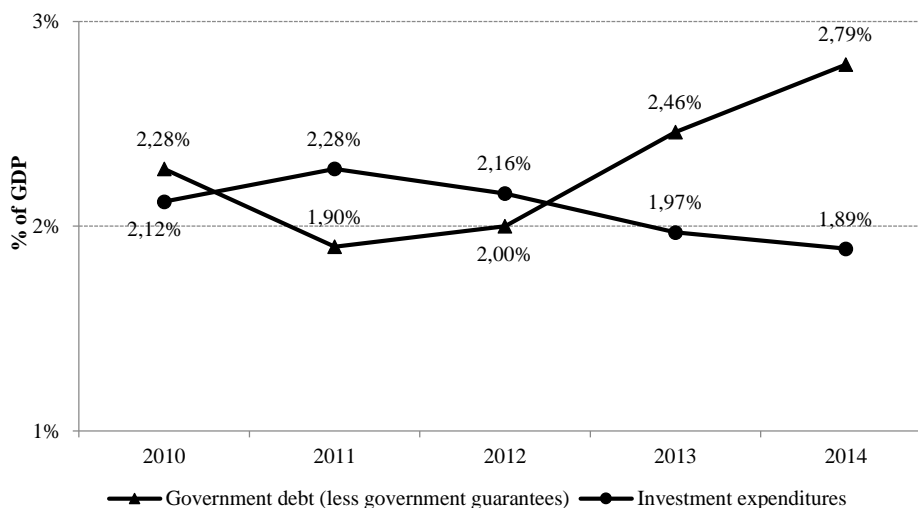
	% of total		% of GDP		Growth, %	
	2013	2014	2013	2014	in nominal terms	in real terms
Nationwide issues	6.2	6.2	0.82	0.81	5.8	-5.1
National security and law-enforcement activity	1.2	1.1	0.16	0.15	0.4	-9.8
National economy, including:	19.6	18.8	2.61	2.48	1.6	-8.8
Agriculture and fishery	3.4	3.0	0.45	0.39	-7.0	-16.5
Transport	3.4	4.1	0.45	0.54	29.4	16.2
Road sector (road funds)	8.3	7.6	1.10	1.00	-3.1	-13.0
Other national economy issues	2.5	2.3	0.33	0.31	1.4	-9.0
Housing and utilities sector	10.2	9.6	1.36	1.27	-0.1	-10.4
Environment protection	0.3	0.3	0.04	0.04	2.5	-8.0
Education, including:	26.5	26.2	3.53	3.45	5.1	-5.7
Pre-school education	6.7	7.0	0.90	0.92	10.3	-1.0
General education	15.0	15.0	1.99	1.97	6.1	-4.8
Secondary professional education	1.6	2.1	0.21	0.27	36.8	22.8
Other education issues	1.6	1.4	0.22	0.19	-8.0	-17.4
Culture and cinematography	3.3	3.4	0.44	0.45	10.6	-0.7
Health care	14.2	13.9	1.89	1.83	3.7	-6.9
Social policy	14.9	15.1	1.98	1.99	7.8	-3.2
Physical culture and sports	1.9	2.0	0.26	0.27	11.6	0.2
Mass media	0.5	0.5	0.06	0.06	4.7	-6.1
Government and municipal debt servicing	1.0	1.3	0.14	0.17	33.5	19.8
Expenditure – total	100.0	100.0	13.30	13.18	6.2	-4.7

Source: RF Federal Treasury; authors' calculations.

¹ In 2013, 51 subjects of the Russian Federation experienced a decline in the amount of their revenue proper in real terms. Over the same period the amount of profits tax receipts in real terms dropped by more than 25% in 23 regions. Meanwhile, the receipts of PIT increased practically in every region.

Our analysis of the movement of various expenditure items in regional budgets has led to the following observations. In 2014, the most impressive expenditure decline was demonstrated by *Housing and Utilities Sector* (-0.1% in nominal terms and -10.4% in real terms). As shown by the year-end results, the share of housing and utilities expenditures in the total amount of expenditure shrank from 10.2% to 9.6%. This happened in the main due to the decline in regions' allocations to investment. On the whole, expenditure decline in real terms was observed with regard to every budget item, with the exception of *Physical Culture and Sports* (growth by 0.2%) and *Government and Municipal Debt Servicing* (19.8%). The positive dynamics of expenditures allocated to *Physical Culture and Sports* can be explained, among other things, by the necessity to provide funding for the infrastructure projects launched in the framework of preparations for the 2018 FIFA World Cup. The amount of expenditure allocated to *Government and Municipal Debt Servicing* increased due to growth in the volume of government and municipal debt by 20.2% and 8.4% respectively (for further detail, see Section 2.3.3). First of all, the year 2014 saw an increase in the volume of regions' commercial debt (by 28.6% on the year-end index for 2013), simultaneously with the increasing share of expenditure allocated to the servicing of this relatively costly debt in the overall structure of expenditure (from 1.0 to 1.3%) and their share in GDP (by 0.03 pp. – from 0.14 to 0.17% of GDP).

On the whole, the amount of expenditures in nominal terms rose with regard to all budget items except *Housing and Utilities Sector*. At the same time, the trajectory of by-subitem movement of expenditure was less homogenous. Thus, the amount of expenditure allocated *Agriculture and Fishery* and *Road Sector (Road Funds)* dropped not only in real terms (by 16.5% and 13.0% respectively), but also in nominal terms (by 7.0% and 3.1% respectively). The decline by 8.8% in real terms in the amount of expenditure allocated to *National Economy* was caused primarily by the shrinking investment under all the major budget items. In recent years, the amount of government investment in the regions has been displaying a stable downward trend (Fig. 18).



Note. Investment expenditures are understood as operations compatible with the definitions stipulated in Articles 310–330, 530 of the Classification of Operations in the State Management Sector (COSMS [KOSGU]).

Source: RF Federal Treasury; RF Ministry of Finance; Rosstat; authors' calculations.

Fig. 18. Government Debt and Investment Expenditures of Subjects

of the Russian Federation in 2010–2014¹

From 2012 onwards, investment expenditures have been on the decline, and the amount of government debt in terms of share in GDP – on the rise. Thus, in the interval from 2011 through 2014, government debt increased from 1.9% to 2.8% of GDP, while investment expenditures, on the contrary, shrank from 2.4% to 1.9% of GDP. As a result, it appears that there is no connection between the level of investment expenditures and the volume of government debt, and so at least some part of newly borrowed funds is earmarked for covering running expenditures. When borrowed funds are used to solve current problems, the debt burden is thus shifted onto the next generations. A short-term decline in investment expenditures, especially when it occurs in a difficult economic situation, represents a measure traditionally applied in the management of public finance in order to boost budget sustainability. The process of public infrastructure development is usually only slightly affected by a reduced funding flow. However, cuts in investment expenditures over a long-term period may produce a grossly underdeveloped infrastructure in the long run, and consequently these territories can become economically backward.

Besides, it is very important also to look at the movement of the main parameters of RF subjects' consolidated budgets in terms of share of GDP (and not only consolidated budget expenditure) (*Table 17*).

Table 17

The Movement of Consolidated Budget Revenue and Expenditure of Subjects of the Russian Federation in 2007–2014, as % of GDP

	2008	2009	2010	2011	2012	2013	2014
Revenue	15.02	15.27	14.12	13.66	12.98	12.33	12.32
including:							
Profits tax	4.24	2.76	3.28	3.44	3.19	2.60	2.96
PIT	4.04	4.29	3.87	3.57	3.64	3.78	4.05
Transfers from FB	2.65	3.81	2.98	2.58	2.32	2.29	2.18
Expenditure	15.15	16.12	14.33	13.72	13.42	13.30	12.98
Deficit (-)/ Surplus (+)	-0.13	-0.85	-0.22	-0.06	-0.45	-0.97	-0.66
For reference: GDP, bn Rb	41, 277	38, 807	46, 309	55, 967	62, 147	66, 194	70, 976

Note. Data for 2014, less data for the Crimean Federal District.

Source: RF Federal Treasury; *Rosstat*; authors' calculations.

Over the period 2008–2014, the highest volume of both consolidated regional budget revenue and consolidated regional budget expenditure in terms of share in GDP was observed in 2009. Growth of revenue in 2009 occurred due to the significantly increased amount of transfers from the federal center to the regions (from 2.7% of GDP in 2008 to 3.8% of GDP in 2009), while the rising volume of expenditure can be explained by the implementation of the anti-crisis program (both federal expenditure through the allocation of subsidies and subventions, and expenditure on the regional level). However, the volume of revenue in regional budgets actually *fell in 2009* on the previous year - by 12% in real terms. Thus, it would be more correct to apply as a base for comparison the data for the entire pre-crisis year-long period 2008 (the crisis-linked trends in the budgetary sphere became noticeable only in the last few months of 2008).

¹ It should be noted that reliance on data grouped in accordance with the Classification of Operations in the State Management Sector (COSMS [*KOSGU*]). is fraught with certain problems, because part of the expenditures that should be treated as investment may instead be charged to the item 'gratis transfers to state and municipal organizations' (as part of subsidies to autonomous and budget-funded organizations). However, the bulk of investment expenditures, as before, is being recorded separately.

From the data presented in *Table 17* it follows that, while the receipts of PIT in 2014, when taken in terms of share in GDP, rose to their pre-crisis level recorded in 2008, the other two major revenue sources – profits tax and interbudgetary transfers – were significantly below their 2008 indices (this is especially true for profits tax). As for the volume of expenditure, it also became significantly lower: 13% of GDP in 2014 vs. 15.2% of GDP in 2008. However, as noted earlier, this was achieved in the main by bringing down the volume of investment expenditures. The financial pattern visible in the consolidated regional budgets for 2014 can also be compared with the situation in 2011, when under the conditions of post-crisis economic recovery the subnational budgets were for most part drawn up without a deficit. In this case it is obvious that over the period 2012–2014 the volume of regional revenue dropped by 1.3 pp. of GDP, while expenditure could be reduced by only 0.7 pp. of GDP, which resulted in a general deficit displayed by regional budgets. At the same time, the sum of receipts from the two major source of tax-generated revenue in 2014 turned out to be the same as in 2011 – 7% of GDP (due to the increased PIT receipts and the shrinkage of the profits tax receipts in terms of share in GDP over the period under consideration). Meanwhile, the volume of interbudgetary transfers declined by 0/4 pp. of GDP, which was ultimately the principal factor responsible for the reduced total sum of revenue in terms of share in GDP received by RF subjects.

It only thanks to the decline in the volume of expenditure from 13.3% of GDP in 2013 to 13.0% of GDP in 2014 that the consolidated budget of RF subjects for 2014 could be drawn up with a lower deficit than the corresponding budget for 2013 (-0.66 vs. -0.97% of GDP respectively), while the volume of revenue remained practically at the same level as in the previous year (12.3% of GDP). In 18 regions, expenditure declined on 2013 even in nominal terms. The most impressive decline could be noted in Chukotka Autonomous Okrug (-20%), in Amur Oblast (-16.7%), in Belgorod Oblast (-9.2%), in Jewish Autonomous Oblast (-7.2%), in Smolensk Oblast (-6.4%), and in Ryazan Oblast (-5.6%). It is noteworthy that in 2014, 17 out of the 18 regions where budget expenditure declined were dependent on dotations from the federal budget. Only Tyumen Oblast, with its high budget sufficiency level, managed to bring down the volume of its expenditure on its own.¹

Now we are going to discuss in more detail the situation with regard to execution of the consolidated budget of RF subjects (deficit/surplus) in each individual region (*Table 18*).

Table 18

The Execution (deficit/surplus) of the Consolidated Budgets of Subjects of the Russian Federation in 2008–2014

Year	Number of RF subjects where budget is executed with	
	deficit	surplus
2008	45	39
2009	62	21
2010	63	20
2011	57	26
2012	67	16
2013	78	5
2014*	74	9

* less data for the Crimean Federal District's regions.

Source: RF Federal Treasury; authors' calculations.

¹ Besides, that particular region was able to bring down its volume of government debt by 55.6% on the corresponding index as of 1 January 2014.

The data presented in *Table 18* point to the fact that the 2014 index for how well-balanced the consolidated budgets of RF subjects are has remained practically at the same level as in 2013. While in the previous year 78 regions had executed their budget with a deficit, their number in 2014 dropped to 74. It should be noted that in 2014, budget deficit was displayed by 5 RF subjects that in 2013 had had a surplus (Moscow Oblast, St. Petersburg, the Republic of Karachaevo-Cherkessia, the Republic of Chechnya, and Kamchatka Krai). At the same time, in 3 of these 5 regions the amount of expenditure increased at a rate that was above Russia's national average (4.6% in nominal terms).¹

On the whole it can be said that, in 2014, the situation with regard to execution of the consolidated budget of RF subjects remained rather tense. In spite of the observable decline in the volume of expenditure, the volume of revenue was such that regional budgets could not for most part become well-balanced. One of the main factors responsible for stagnation in the sphere of regional revenue over recent year was the movement of transfers allocated from the federal budget.

2.3.2. Financial Aid from the Federal Budget

In 2014, the total volume of interbudgetary transfers received by the consolidated budget of RF subjects dropped on 2013 by 3.1% in real terms (*Table 19*).

Table 19

Transfers from the Federal Budget to Subjects of the Russian Federation in 2008–2009 and 2013–2014

	2008		2009		2013		2014		Growth in 2014 on 2013, %	
	bn Rb	% of total	bn Rb	% of total	bn Rb	% of total	bn Rb	% of total	in nomin al terms	in real terms
Transfers to regions, total	1,094.7	100.0	1,480.3	100.0	1,487.9	100.0	1,607.0	100.0	8.0	-3.1
Dotations	390.4	35.7	578.3	39.1	609.1	40.9	774.7	48.2	27.2	14.2
Including:										
dotations to budget sufficiency equalization	328.6	30.0	374.0	25.3	418.8	28.1	439.8	27.4	5.0	-5.7
dotations to support measures designed to ensure well-balanced budgets	46.0	4.2	191.9	13.0	177.8	12.0	334.9	20.8	88.3	69.1
Subsidies	435.9	39.8	530.0	35.8	515.6	34.7	409.9	25.5	-20.5	-28.6
Including:										
subsidies to sustain national economy's development	181.2	16.5	214.3	14.5	268.3	18.0	241.9	15.1	-9.8	-19.1
Subventions	153.2	14.0	284.4	19.2	273.7	18.4	308.2	19.2	12.6	1.1
Other interbudgetary transfers	115.2	10.5	87.6	5.9	89.5	6.0	114.2	7.1	27.7	14.6

Source: RF Federal Treasury; authors' calculations.

The trends displayed by various types of transfers had different vectors, thus altering the overall structure of financial aid. Thus, in 2014, the volumes of the following types of transfers increased on 2013: transfers in the form of dotations (growth by 14.2% in real terms); other interbudgetary transfers (hereinafter 'other IBT) – by 14.6%; and subventions - by 1.1%. At the same time, the movement of various components within each transfer category differed. In

¹ Less the expenditures of the Crimean Federal District's regions.

particular, the total volume of dotations increased in the main due to the higher amount of dotations earmarked for the support of measures designed to ensure well-balanced budgets (growth by 69.1%). Such a surge was caused by the expenditures allocated in the framework of the government subprogram *Support of Sustainable Budget Execution by Subjects of the Russian Federation and Local Budget Execution* (49.5% of the total sum of dotations to support measures designed to ensure well-balanced budgets (Rb 165.9bn)), as well as the expenditures earmarked for compensation, in part, for the increased salaries in the budget-funded sphere (35.8% (Rb 120bn)) in connection with the implementation of the RF President's Executive Order of 7 May 2012. At the same time, in 2014, the amount of dotations to budget sufficiency equalization, on the contrary, shrank by 5.7% in real terms on 2013. Meanwhile, the share of dotations in the total volume of transfers on the whole increased from 40.9% in 2013 to 48.2% in 2014. On the one hand, the higher share of non-targeted transfers in the total volume of transfers boosts the regions' ability to independently implement their socioeconomic policies. However, on the other hand, from the point of view of economics, the dotations earmarked as compensation for the increased salaries in the budget-funded sphere are more like a substitute for subsidies. Consequently, the substantially increased share of dotations coupled with a shrinking share of subsidies (from 34.7 to 25.5%) cannot be regarded as an important move towards greater financial autonomy of Russian regions. And in a more general sense the increased share of dotations designed to ensure well-balanced budgets is a negative factor, because this channel of funding distribution is far less transparent than that of dotations to budget sufficiency equalization.

Subsidies turned out to be the only type of interbudgetary transfers whose amount in 2014 declined both in nominal and in real terms (by 20.5 and 28.6% respectively). The amount of subsidies shrank primarily due to a cut in the expenditures earmarked for the support of the national economy (by 19.1%). The positive vectors displayed by subventions and other IBT (growth in real terms by 1.1% and 14.6% respectively on 2013) also contributed to changes in the overall structure of transfers. Thus, the share of subventions increased from 18.4% to 19.2%, while that of other IBT in the total volume of interbudgetary transfers increased from 6% to 7.1%.

When analyzing the process of transfer allocation by the federal center to the regions, it is essential to review the impact of federal aid from the federal budget on the differentiation of the budget revenue of subjects of the Russian Federation, and to assess its actual equalizing effect (*Table 20*).

Table 20

**The Variance Coefficient of the Consolidated Regional Budget Revenue
(per Capita, with Due Regard for the Budget Expenditure Index)
in 2008–2014., as %**

Year	Tax-generated revenues	Tax-generated revenues and dotations to budget sufficiency equalization	Tax-generated revenues, dotations, subsidies
2008	90.6	80.4	71.5
2009	78.3	66.5	54.5
2010	74.2	63.9	57.8
2011	77.8	68.4	61.6
2012	66.1	57.8	51.9
2013	63.7	55.3	48.1
2014	59.0	51.2	49.9

Note. No calculations were done for the Crimean Federal District's regions.

Source: RF Federal Treasury; RF Ministry of Finance; authors' calculations.

As can be seen from data presented in *Table 20*, the year 2014 saw a continuation of the downward trend in revenue differentiation displayed by subnational budgets. The variance coefficient of tax-generated revenue in the consolidated budget of RF subjects declined from 63.7% in 2013 to 59% in 2014. After the allocation of dotations to budget sufficiency equalization, the variance coefficient of regional budget revenue dropped to 51.2% in 2014. If we wish to adequately assess the resulting figure after the allocation of all dotations and subsidies, it must be borne in mind that the instrument of dotations has become less efficient from the point of view of budget sufficiency differentiation among the regions: the relevant variance coefficient slightly increased in 2014 to 49.9% (vs. 48.1% in 2013) and so, as the values of the first two variance coefficient declined, their ratios significantly dropped.

It is important to note that, from 2010 onwards, the total volume of transfers to subnational budgets has been gradually declining (*Fig. 20*). When taken in real terms, the volume of transfers displays a downward trend. While in 2008 this index amounted to Rb 1,094.1bn, in 2014 it was Rb 1,077.4bn, and by 2017 the amount of transfers may shrink to Rb 897.6bn (in 2008 prices). In the medium-term period (from 2014 through 2017) it can be expected that three types of transfers will be on the decline: subsidies (by 28.2%), dotations (26.8%), and subventions (13.3%). Only ‘other interbudgetary transfers’ are expected to grow in real terms by 84.2%. The most impressive decline will happen with regard to the volume of subsidies. The consolidation and decline of the share of subsidies in the total volume of interbudgetary transfers from the federal budget alongside a simultaneous increase of the share and volume of equalizing dotations could result in an improved structure of interbudgetary transfers, greater independence of the regions in pursuing their own budgetary policies, and thus in more efficient interbudgetary relations. But the decline in the volume of targeted interbudgetary transfers is not compensated for by an increasing volume of non-targeted transfers.

If we look more carefully at the adjusted parameters in the latest law on the federal budget,¹ it can be noticed specifically with regard to the year 2015 that the planned shrinkage of the total volume of interbudgetary transfers to subjects of the Russian Federation will amount to Rb 145bn, which corresponds to 9.2% of the total amount initially allocated to the budget for 2015, and that the net growth of budget loans to regional budgets will amount to Rb 212bn, being produced by the reduced target for budget loan repayment by the regions (by Rb 52bn) and the increased volume of budget loans issued to the regions (by 160bn). As far as the reduction of the total volume of interbudgetary transfers is concerned (by Rb 145bn), dotations will account for Rb 58.7bn, subsidies – for Rb 49.75bn, subventions – for Rb 22.7bn, and other IBT – for Rb 13.86bn. As a result, the total volume of interbudgetary transfers to the regions will amount to 1.95% of GDP, which is a record low for the past 10–15 years. It is also noteworthy that the federal government has fundamentally altered some of the principles of its budgetary policy aimed at providing support to the regions during times of crisis: if back in 2009 the total volume of interbudgetary transfers to the regions increased on the previous year by 1.1% of GDP to 3.8% of GDP, in 2015, on the contrary, it can be expected that the volume of gratis financial aid provided to the regions will decline by 0.3% of GDP on the previous year. In fact, this points to a change in the general vector of the Federation’s budgetary policy towards the regions, the countercyclical approach giving way to the procyclical one.

¹ In accordance with the draft of Federal Law No 744090-6 ‘On Introducing Alterations to the Federal Law “On the Federal Budget for 2015 and Planning Period 2016 and 2017”’.

2.3.3. An Analysis of the Situation with Government and Municipal Debt

The data on the movement of the amount of government debt held by subjects of the Russian Federation and that of municipal debt over the period 2011–2014 are presented in *Table 21*. As can be seen from these data, the aggregate volume of debt in regional and municipal budgets increased significantly over the course of the year 2014. Thus, the growth of government debt held by subjects of the Russian Federation amounted to 20.2%, having increased from 2.6% to 2.9% of GDP. Similarly to the pattern observed over the past few years, the bulk of borrowing occurred only in the course of a single month (December), when the amount of debt increased by Rb 226.9bn to Rb 2,089bn (growth of 12.8% on the previous month). The amount of municipal debt over the same period increased by 10.9% (from Rb 282.4bn to Rb 313.2bn). On the whole over the course of that year, the volume of municipal debt increased by 8.4%.

Table 21

Government and Municipal Debt in the Subnational Budgets in 2011–2014.

	2011	2012		2013		2014	
	volume	volume	change	volume	change	volume	change
Total debt in regional budgets, bn Rb	1, 171.8	1, 355.0	183.2	1, 737.5	382.5	2, 089.0	351.5
<i>Rate of growth on previous year, %</i>	-	15.6		28.2		20.2	
Total debt in regional budgets, % of GDP	2.1	2.2	0.1	2.6	0.4	2.9	0.3
Total debt in municipal budgets, bn Rb	215.5	245.3	29.8	288.9	43.6	313.2	24.3
<i>Rate of growth on previous year, %</i>	-	13.8		17.8		8.4	
Total debt in municipal budgets, % of GDP	0.39	0.39	0.00	0.44	0.05	0.44	0.00

Source: RF Ministry of Finance; Rosstat; authors' calculations.

It should be noted that while previously the bulk of regional debt had been held by only 2 regions – the city of Moscow and Moscow Oblast (as of 1 January 2011 – 40.7%, and as of 1 January 2012 – 29% of aggregate regional debt), as of 1 January 2015 these two regions already accounted for only 12.7% of the aggregate debt volume (which is 2.5 pp. below the index recorded as of 1 January 2014). At the same time, over the year 2014 within this group of regions, Moscow Oblast increased the amount of its debt by 22.5% (or by Rb 19bn). However, debt growth occurred in the main due to the build-up of indebtedness against commercial loans (from Rb 38bn in 2013 to Rb 64bn in 2014). The city of Moscow, on the contrary, over the year 2014 reduced its debt volume by 57.6%.

As of the end of 2014, the leaders in borrowing (assessed by the accumulated debt volume in excess of Rb 100bn) were Moscow Oblast (Rb 161.7bn), Krasnodar Krai (Rb 136.3bn), and the city of Moscow (Rb 103.1bn).

On the whole, the fact of an increasing debt burden on many subjects of the Russian Federation is also confirmed by the data broken up by group of regions (*Table 22*).

Over the course of the year 2014, in 74 out of 82 subjects of the Russian Federation (less the Crimean Federal District) the volume of government debt increased, and significant growth in the debt volume (by more than 15%) was observed in 56 regions. In 12 subjects of the Russian Federation the volume of debt rose by more than 50%, including Perm Krai (2,184.6%), Irkutsk Oblast (273.8%), Magadan Oblast (153.6%), Rostov Oblast (79.2%) and Kamchatka Krai (65.8%).

Table 22

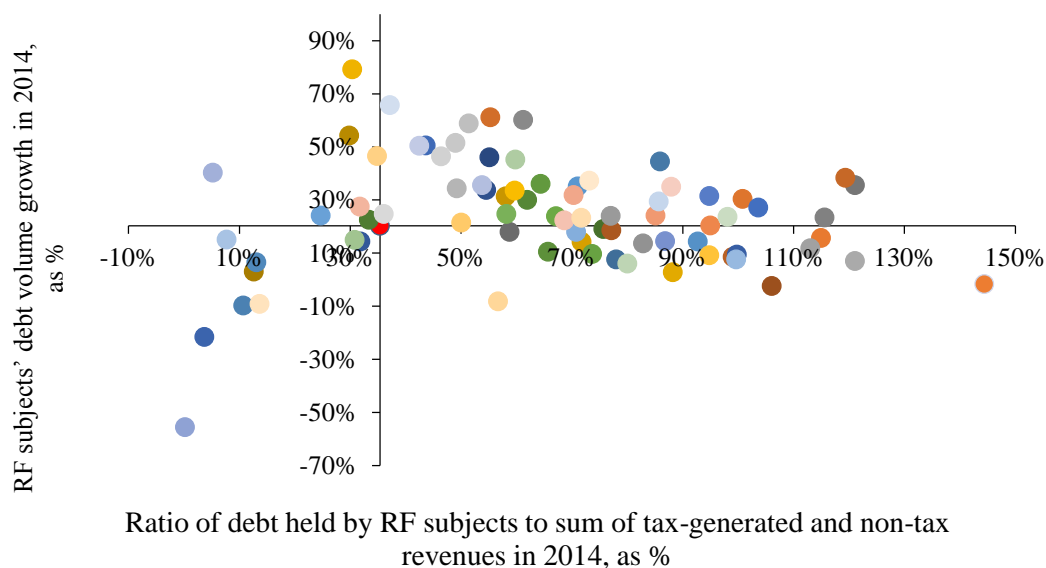
The Movement of the Volume of Government Debt in the Budgets of Subjects of the Russian Federation in 2008–2014

Number of regions in	Movement of government debt volume held by subjects of Russian Federation over given period (in nominal terms), number of subjects of Russian Federation						
	growth by more than 50%	growth by between 15% and 50%	growth by less than 15%	no change	decline by less than 15%	decline by between 15% and 50%	decline by more than 50%
2008	21	20	10	3	5	13	10
2009	37	18	11	4	6	4	2
2010	30	24	9	1	11	7	0
2011	21	27	13	1	14	6	0
2012	18	31	14	0	8	10	1
2013	31	36	8	0	6	1	0
2014	12	44	18	0	5	1	2

Note. 1. No calculations were done for the Crimean Federal District's regions. 2. Arkhangelsk Oblast and Nenets Autonomous Okrug are treated for the purpose of our calculations as one and the same subject of the Russian Federation.

Source: RF Ministry of Finance; authors' calculations.

Especially alarming is the situation in those regions where, in 2014, not only the volume of debt surged, but the debt burden also significantly increased; the latter represents the ratio of government debt volume to the level of tax-generated and non-tax revenues of a given subject of the Russian Federation (*Fig. 19*).



Note. 1. The intersection of the axes is the point where the values of debt burden and RF subjects' debt volume growth over 2014 become equal to Russia's average (38.4 and 20.2% respectively). 2. This graph does not show Perm Krai (16.7%, 2,184.6%), Irkutsk Oblast (14.4%, 273.8%), Magadan Oblast (52.2%, 153.6%). 3. No calculations were done for the Crimean Federal District's regions.

Source: RF Federal Treasury; Federal Law of 1 December 2014, No 384-FZ 'On the Federal Budget for 2015 and Planning Period 2016 and 2017'; authors' calculations.

Fig. 19. The Debt Burden and the Movement of Government Debta Held by Subjects of the Russian Federation in 2014

From data presented in *Fig. 19* it follows that in 2014, in 40 out of 82 subjects of the Russian Federation the rates of growth displayed by the government debt and the debt burden were above Russia's national average. It should be noted that in 10 subjects of the Russian Federation the debt burden rate was found to be higher than the volume of tax-generated and non-tax revenues: in Belgorodya Oblast (106.1%); in Kostroma Oblast (121.1%); in Smolensk Oblast (115.6%); in the Republic of Karelia (119.3%); in Astrakhan Oblast (100.8%); in the Republic of North Ossetia – Alania (114.9%); in the Republic of Ingushetia (113%); in the Republic of Karachay-Cherkessia (103.6%); in the Republic of Mordovia (121.1%); and in Chukotka Autonomous Okrug (144.4%). In 2013, there were seven such regions. In spite of the overall trend towards increasing the amount of debt, in some regions with the highest debt burden it was successfully reduced, however slightly, which means the onset of the process of budget consolidation. Thus, for example, in 2014, in the Republic of Mordovia the debt burden index was brought down from 172.1 to 121.1%, in Belgorod Oblast – from 110.3 to 106.1%. At the same time, among those 7 regions where the year-end results of 2013 demonstrated the debt burden index to be above 100%, in 2014 it was further increased in 3 regions: Chukotka Autonomous Okrug (from 123% to 144.4%), the Republic of Ingushetia (from 103.2 to 113%) and the Republic of North Ossetia – Alania (from 103.2 to 114.9%). Saratov Oblast and Vologda Oblast, as demonstrated by their year-end results of 2014, no longer belong to the group of regions with the highest volume of debt liabilities; however, the level of debt burden in these RF subjects is still rather high: 99.7 and 99.8% respectively.

On the whole, in spite of the slight slowdown in the rate of growth displayed by government and municipal debt, the situation in this sphere continues to deteriorate. The overall amount of debt in subnational budgets has nearly hit the mark of 3% of GDP. In the majority of region, the volume of borrowing is on the rise, and in some RF subjects the level of debt burden continues to be excessively high. Some of the regions that had already been shouldering an impressive debt burden failed to revise their regional budgetary policies and bring down their debt levels. The recent changes in the structure of regional debt have also given some grounds for concern (*Fig. 20*).

From 2011 onwards, within the overall debt structure, a stable growth of the share of commercial (bank) loans has become visible. One serious drawback of commercial loans is the higher cost of their servicing by comparison with budget loans. However, in view of the limited supply of budget loan on the part of the federal center, this instrument has been actively resorted to by many Russian regions. Thus, as shown by the year-end results of 2014, in 11 RF subjects the share of commercial loans in the total debt volume at a level above 75%.

In order to reduce the risks associated with the increasing debt burden shouldered by the regions, the higher amount of funding earmarked in the federal budget for covering the cost of budget loans in 2014 was intended, among other things, to ensure the refinancing of commercial debt, and thus to curb the growth of expenditures allocated to debt servicing.

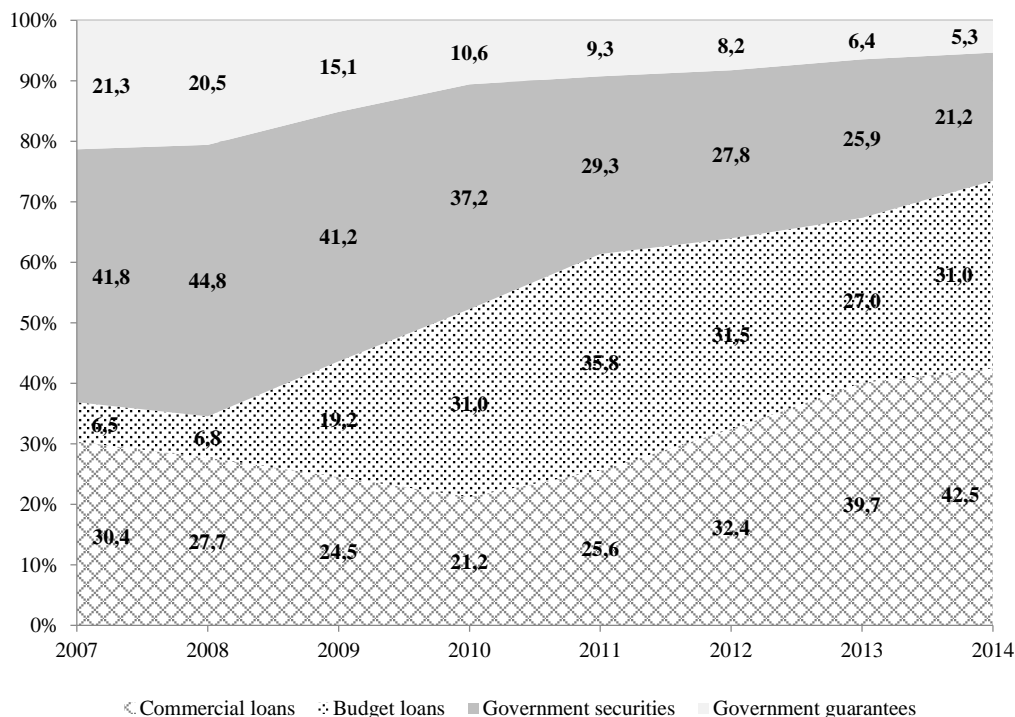
In 2015, this practice will be continued. For the year 2015, the following conditions for the allocation of budget loans earmarked for commercial debt refinancing are established¹:

¹ Order of the RF Ministry of Finance No 41 of 24 February 2015 'On Granting, to the Budgets of Subjects of the Russian Federation, of Budget Loans from the Federal Budget to Cover Part of Their Deficit, for the Purpose of Redemption of the Debt Liabilities of Subject of the Russian Federation Held in the Form of Liabilities against Loans Received by Subjects of the Russian Federation from Credit Institutions'.

– if a loan received in 2015 by a subject of the Russian Federation from a credit institution is issued to that subject of the Russian Federation for a period longer than 1 year at a variable rate pegged to the Bank of Russia’s key rate and increased by more than 1.5 pp., with a mandatory requirement that the interest rate on the loan should be correspondingly altered no later than within 10 calendar days after the Bank of Russia has changed its key rate;

– if the consolidated budget of a subject of the Russian Federation is expected to be drawn up with a deficit for reasons that cannot be controlled by that subject of the Russian Federation, and the budget deficit will result (or may result) in that subject of the Russian Federation’s inability to effectuate, in due time in the course of a current quarter (or a current financial year), the necessary payments against the loan received from a credit institution on certain specially determined terms;

– if the volume of payments made over the course of a current financial year against the loan received from a credit institution by a subject of the Russian Federation does not exceed the ceiling set for the current financial year.



Source: RF Ministry of Finance; authors’ calculations

Fig. 20. The Structure of Regional Debt in 2007–2014, as %

Considering the general rise in the debt burden shouldered by the regions from 15.2% as of 1 January 2009 to 35.4% as of 1 January 2015, the planned reduction in the total volume of interbudgetary transfers in 2015 will have a negative effect on the financial status of the regions, even if the volume of issued budget loans should be increased. So, it will become necessary not only to make further cuts to regional investment in infrastructure projects, but also to downsize the existing network of state and municipal institutions. The dwindling flow of gratis financial aid to the regions will also impose serious constraints on their ability to implement anti-recession measures. According to our estimations, in 2015, the resulting decline on 2014 in the

total volume of budget expenditure in the consolidated budgets of subjects Russian Federation may amount to 1% of GDP.