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The review provides a detailed analysis of main trends in Russia's economy in 2010. 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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Intergovernmental Fiscal Relations and Subnational Finances

2.3.1. Subnational Budgets in 2010

Basic trends concerning relations between different levels of power are reflected in the structure of revenues and expenditures of the consolidated budget of the Russian Federation. Data on a share of tax revenues and expenditures of the constituent territories of the Russian Federation in the relevant items of the consolidated budget of the Russian Federation is shown in *Table 16*.

Table 16

**A share of specific values of the budget of the constituent territories
of the Russian Federation in the consolidated budget
of the Russian Federation in 1992 – 2010 (%)**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Tax revenues	44.2	53.1	53.4	47.6	49.5	53.1	56.6	49.2	43.5	37.4	35.1	39.6	36.1	30.9	31.8	33.9	33.2	36.6	37.2
Tax revenues, net of natural resource charg- es and customs duties	47.7	61.7	61.4	56.0	55.8	59.5	59.9	53.0	49.0	42.6	40.1	41.9	47.5	49.1	52.0	50.5	53.7	54.8	57.1
Expenditures	34.0	40.3	37.7	43.4	45.4	48.1	54.1	51.9	54.4	54.2	49.3	50.0	50.8	49.5	43.4	48.3	49.2	43.4	43.2

Data Source: The Federal Treasury, the estimates were made by the Gaidar Institute.

The following is worth highlighting in analyzing the data presented in *Table 16*. A share of tax revenues of the constituent territories of the Russian Federation in the consolidated budget decreased considerably from 56.6 to 30.9% over the period between 1998 and 2005. This trend was conditioned by economic situation (growth in prices of energy resources resulted in increase of revenues from customs duties and natural resource charges due to the federal budget), rather than redistribution of sources of revenues between different levels of the budget system. The fact that a share of subnational budgets in tax revenues of the consolidated budget, net of natural resource charges and customs duties, decreased less during the same period, from 59.9% in 1998 to 49.1% in 2005, can be used as evidence. A share of subnational budgets in tax revenues of the consolidated budget of the Russian Federation was reported to increase in the period between 2006 and 2007, because revenues from taxes payable to regional budgets increased faster than tax revenues of the federal budget. In 2008 this share slightly decreased but remained at a much higher level than in 2005. A share of regional budgets in tax revenues of consolidated budget, net of natural resource charges and customs duties, increased visibly in 2008 over the level of 2007.

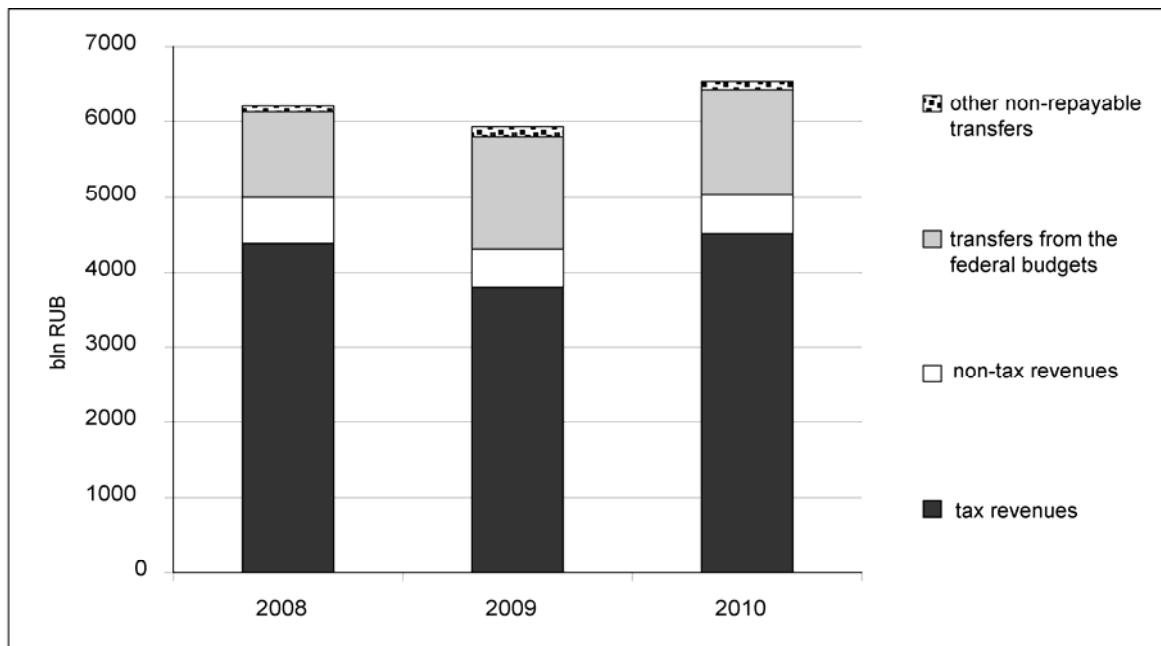
The economic downturn of 2009 had an effect on the relations under review. A share of tax revenues of the constituent territories of the Russian Federation increased considerably from 33.2 to 36.6% in the relevant revenues of the consolidated budget of the Russian Federation, which was conditioned to a large extent by a slump of federal budget revenues from mineral extraction tax and customs duties. A share of regional budgets, net of natural resource charges and customs duties, increased as well: by 1.1 p.p., from 53.7 to 54.8%, which was conditioned to a large extent by steady revenues from personal income tax paid to regional budgets during the recession (RUR 1666.2 bln in 2008 and RUR 1665.8 bln in 2009). A certain economic recovery was reported in the Russian industries in 2010. According to the data published by Rosstat, GDP increased by 4% in real terms. A share of regional tax revenues in the consolidated budget of the Russian Federation increased from 36.6 to 37.2% due to a faster growth in volumes of taxes payable to subnational budgets. A share of tax revenues, net of natural resource charges and customs duties, increased more by 2.3 p.p., from 54.8 to 57.1%. On the other hand, a share of subnational budgets in revenues of consolidated budget of the Russian Federation decreased considerably from 49.2% in 2008 to 43.4% in 2009, and remained almost the same, 43.2%, in 2010. The foregoing trends was indicative of a marked reduction in the vertical gap in the Russian budget system by aligning shares of tax revenues and revenues of subnational budgets in the consolidated budget of the Russian Federation. It is well to bear in mind that this trend was reported due to a drastic decrease in federal budget revenues in 2009 accompanied by a substantial growth in the federal government expenditures (by 27.4% in nominal terms against the level of 2008) which were covered with accumulated financial reserves.

In light of the recent trends, the Russian expert community's traditional point of view on that the budget system is vertically unbalanced through excessive concentration of tax revenues in the federal budget. The following arguments may cast some doubt on this point of view:

- federal budget revenues include a big share of “natural resource rent” which is extremely unstable and likely to keep reducing as percentage of GDP ;
- the federal budget includes the largest cost-related obligation – financing of the pension system deficit. Ageing of the population will result in growth in expenditures on pension provision and demand for “grants” from the federal budget;
- regional and local budgets include almost all of the taxes, save for “natural resource rent”, namely personal income tax, a “lion’s share” of profit tax (18% of 20%), corporate property tax. Should the country follow the post-industrial (non-primary) scenario, a share of these taxes would be increasing in total revenues of the consolidated budget of the Russian Federation. On the other hand, the federal budget has only one large source of tax revenues, VAT, which would remain relevant under the non-primary sector development model.

Therefore, any substantial tax revenues are unlikely to be allocated to the subnational level.

Let's take a closer look at the situation with revenues of subnational budgets. Dynamics of basic elements of revenues of the consolidated budgets of the constituent territories of the Russian Federation in the period between 2008 and 2010 is presented in *Fig. 14*.



Data Source: The Federal Treasury, the estimates were made by the Gaidar Institute.

Fig. 14. Revenues of the consolidated budget of the constituent territories of the Russian Federation in 2008 – 2010, by component (in nominal terms)

Tax revenues of consolidated budget of the constituent territories of the Russian Federation increased by 19.2% in nominal terms in 2010 against the previous year, their share in overall revenues of regional budgets increased from 64.0 to 69.1%. Tax revenues increased in volume by 9.5% in real terms against the level of 2009 whereas kept decreasing by 12.9% against the level of 2008. One may say that in general tax revenues of regional budgets therefore failed to catch up with the pre-recession values both in volume terms and as percentage of overall revenues of the consolidated budget of the constituent territories of the Russian Federation (this share was 70.7% in 2008). Tax revenues tended to decrease in volumes by 1.8% in nominal terms. As a result, while in 2008 these revenues accounted for 9.8% of the overall revenues of the budget of the constituent territories of the Russian Federation, they decreased to 8.7% in 2009 and 7.7% in 2010. Transfers from the federal budget also decreased in volume to 6.0% in nominal terms against the level of 2009. In spite of a slight reduction, however, volume of transfers remained beyond the level of 2008 in comparable prices (a 4.3% growth in real terms). A similar situation developed with regard to other non-repayable transfers to the consolidated budget of the constituent territories of the Russian Federation: a 14.1% reduction in nominal terms against the level of 2009 and a 32.3% growth in real terms against the level of 2008. It should be noted that most of the other non-repayable transfers from the Fund for the Promotion of the Reform in the Housing and Public Utility Sector. As a result, though a share of non-repayable transfers in revenues of subnational budgets reduced from 27.0% in 2009 to 22.8% in 2010, it kept outstripping the value of 2008 (19.1%). In general, revenues of the consolidated budget of the constituent territories of the Russian Federation increased by 1.4% in real terms in 2010 against the level of 2009 whereas reduced by 10.9% against the level of 2008.

Dynamics of basic tax revenues payable to subnational budgets in the period between 2007 and 2010 are shown in *Table 17*.

Table 17

**Tax revenues inflow to the consolidated budget of the constituent territories
of the Russian Federation in 2007 – 2010, (as % of GDP)**

	2007	2008	2009	2010
Tax revenues, total	10.88	10.63	9.78	10.16
including:				
Corporate profit tax	4.60	4.25	2.76	3.42
Personal income tax	3.81	4.04	4.29	4.02
Excise taxes on goods sold on the territory of the Russian Federation	0.54	0.46	0.63	0.74
Lump-sum taxes	0.37	0.39	0.39	0.40
Property taxes	1.24	1.20	1.47	1.41
Natural resource taxes, dues and regular charges	0.23	0.25	0.19	0.07
<i>For reference: GDP, t RUR</i>	33.25	41.26	38.80	44.49

Data Source: The Federal Treasury, the estimates were made by the Gaidar Institute.

In general, tax revenues of consolidated budgets increased from 9.78% of GDP in 2009 up to 10.16% of GDP in 2010, however, failed to catch up with the level of 2008 (as 10.63% of GDP). Specific types of taxes were multidirectional. Traditionally, there are two taxes which provide basic tax revenues to consolidated regional budgets, namely corporate profit tax and personal income tax, which accounted for about 73% of the total tax revenues in 2010, slightly outstripping the level of 2009 (72%) but being far behind the level of 2008 (78%). The main reason is that though profit tax revenues increased by 0.66 p.p. of GDP to reach 3.42% of GDP, it was markedly below the revenues of 2008 (4.25% of GDP). It should be taken into account, however, that regional rate of this tax raised from 19.5 to 20% from January 1, 2009. Therefore, though a certain recovery in the Russian economy in 2010 resulted in growth in profit tax revenues, the revenues remained far from the pre-recession values as percentage of GDP. Another key tax – personal income tax – showed different dynamics. As reported in the previous review¹, personal income tax was found to be one of the most stable types of tax revenues in consolidated regional revenues amidst the economic downturn. In 2010, personal income tax almost caught up with the level of 2008 as percentage of GDP (as 4.02 and 4.04% of GDP, respectively). The decrease of personal income tax against the level of 2009 can be explained by the fact that it slumped as percentage of GDP in 2009 amidst the economic downturn and increased in the period of recovery of the Russian economy in 2010. The following may be highlighted by examining the dynamics of other tax revenues of the consolidated budget of the constituent territories of the Russian Federation. Excise tax revenues grew steadily as percentage of GDP in the period between 2009 and 2010, mostly because a part of excise tax revenues was transferred from the federal budget to regional budgets in 2009 and excise tax rates increased in 2010. A share of taxes payable by SMEs (lump-sum tax) remained unchanged over the period under review, accounting for 0.4% of GDP in 2010. Property tax revenues, which increased visibly from 1.20 to 1.47% of GDP in 2009, slightly decreased down to 1.41% of GDP in 2010. Nevertheless, the revenues were visibly beyond the value of 2008. The role of mineral extraction tax and other natural resource charges in regional budget revenues decreased in the period between 2009 and 2010. Mineral extraction tax

¹ Russian Economy in 2009. Trends and Outlooks., Moscow, IET, 2010

revenues decreased considerably in 2010, which was connected mostly with centralization of mineral extraction tax revenues as hydrocarbon material in the federal budget¹.

Dynamics of tax revenues in the consolidated budget of the constituent territories of the Russian Federation have been considered in general above. However, analysis by region is also of interest, because the constituent territories of the Russian Federation differed in recession severity and degree of economic recovery. It should be noted that differentiation of tax revenues in regional budget revenues decreased in 2009 and then increased again in 2010. The relevant coefficient of variation of per capita tax revenues given the budget expenditures index was 87.2% in 2008 and 75.0% in 2009, but increased up to 91.3% in 2010, thus outstripping the level of 2008. Such a dynamics were to a large extent linked with the following aspects. As already noted in the previous review, it was the economically developed regions that were hit most by the economic recession, which resulted in some decrease in interregional differentiation. Late in 2009 the Russian economy began to recover but the constituent territories of the Russian Federation differed largely in degree of recovery and, consequently, growth rates of tax revenues, which resulted in increase of differentiation of per capita tax revenues. To better understand the situation with tax revenues by constituent territory, let's take a look at a breakdown of Russian regions in terms of changes in per capita tax revenues in the period between 2009 and 2010 (see *Table 18*).

Table 18

**A breakdown of the Russian regions in terms of changes in tax revenues
of the consolidated budget of a constituent territory of the Russian Federation**

Number regions in which tax revenues	In nominal terms		In real terms	
	in 2009 against the level of 2008	in 2010 against the level of 2009	in 2010 against the level of 2008	in 2010 against the level of 2008
Increased by more than 25%	3	23	25	3
Increased by 10 to 25%	9	52	30	13
Increased by less than 10%	18	4	13	29
Decreased by less than 10%	28	1	10	14
Decreased by 10 to 25%	18	2	3	21
Decreased by more than 25%	6	0	1	2

Data Source: The Federal Treasury, the estimates were made by the Gaidar Institute.

As may be seen from the presented data, a share of tax revenues in consolidated regional revenues decreased in nominal terms in 52 of 82² constituent territories of the Russian Federation amidst the economic downturn in 2009. Exactly the converse situation was observed in 2010, when the Russian economy began to recover: tax revenues in 79 regions increased in nominal terms against the level of 2009. However, since tax revenues decreased at more than a half of the constituent territories in 2009, it was the base effect that had a serious impact on growth figures in 2010. Of special interest, therefore, is comparing volumes of tax revenues

¹ The regulation for crediting the mineral extraction tax revenues as hydrocarbon material (save for the flammable natural gas) to the federal budget was increased from 95 to 100% from January 1, 2010 (The Federal Law dd. September 22, 2009, No. 218-FZ "On the Amendments to Certain Legislative Acts of the Russian Federation and Annulment of Certain Provisions of the Legal Entities of the Russian Federation").

² The Archangelsk Region and the Nenets Autonomous District are regarded as a single constituent territory of the Russian Federation.

with the level of 2008 in both nominal and real terms in order to assess how the situation with regional budget revenues is improved in 2010. Tax revenues increased in nominal terms against the level of 2008 at 68 regions and by more than 10% at 55 constituent territories of the Russian Federation. However, after allowing for inflation in the period between 2009 and 2010, the picture would change substantially. Tax revenues increased in real terms in 2010 against the level of 2008 at 45 regions, accounting for a bit more than a half of the total. Therefore, almost 50% of the constituent territories of the Russian Federation were facing problems with tax revenues inflow in their budgets, of which 16 constituent territories experienced a 10% decrease in tax revenues, at 2008 values, against 2008. The following constituent territories of the Russian Federation experienced most a negative decrease in real terms in 2010 against the level of 2008: the Tyumen Region (– 42.7%), the Vologda Region (– 33.3%), Moscow (– 24.8%), the Perm Territory (– 24.3%), the Kemerovo Region (– 23.3%), the Lipetsk Region (– 22.5%) and the Khanty-Mansi Autonomous Area (– 18.9%). Hence, in 2010, tax revenues decreased in real terms against the level of 2008 mostly at the high-fiscal-capacity economically developed constituent territories of the Russian Federation, which reinforces the foregoing opinion on that these regions were hit most by the economic downturn.

Let's consider the changes which took place in consolidated budget revenues of the constituent territories of the Russian Federation. In 2009, overall expenditures of the consolidated budget of the constituent territories of the Russian Federation remained at the level of 2008 (RUR 6,256.3 bln and RUR 6,253.5 bln, respectively). In 2010 regional expenditures increased by 6.1% in nominal terms against the level of 2008–2009 whereas decreased by 2.5% in real terms against the level of 2009 and by 10.3% against the level of 2008. The structure of expenditures of the consolidated budget of the constituent territories of the Russian Federation was changed as well (see *Table 19*).

Table 19

Structure of expenditures of the consolidated budget of the constituent territories of the Russian Federation in 2008 – 2010, (%)

	2008	2009	2010
Nationwide issues	7.1	7.3	7.3
<i>Including state and municipal debt servicing</i>	0.6	1.0	1.1
National defense	0.0	0.0	0.0
National security and law enforcement	4.1	3.9	3.8
National economy	19.6	18.1	16.6
Housing and public utility sector	16.3	13.7	12.6
Environmental protection	0.3	0.3	0.2
Education	20.8	21.5	21.9
Culture, cinematography and mass media	3.5	3.4	3.4
Healthcare and sports	12.7	12.1	12.0
Social policy	12.2	15.3	17.6
Intergovernmental fiscal transfers	3.3	4.4	4.5

Data Source : The Federal Treasury, the estimates were made by the Gaidar Institute.

The following can be highlighted by examining changes in major subsections of regional budgets. In general, the trends which emerged as early as the pre-recession year of 2009, continued in 2010. Expenditures under “national economy” and “housing and public utility sector” kept decreasing to reach 16.6% and 12.6% (against 18.1% and 13.7% in 2009), respectively, whereas expenditures on social policy increased even more to account for 17.6% of the overall expenditures in 2010 (against 15.3% in 2009). Expenditures under “education” as well as “healthcare and sports” changed insignificantly in 2010: the former kept increasing

gradually to reach 21.9% in 2010, whereas the latter kept decreasing gradually down to 12.0%. A slight decrease in expenditures under “healthcare” was also related to increase in transfers from regional budgets to territorial funds of compulsory medical insurance. As a result, in 2010 a cumulative percentage of sections “healthcare and sports” and “intergovernmental fiscal transfers” remained at the level of 2009 (16.5%). Expenditures under “nation-wide issues” also remained at the level of 2009 (7.3%), and expenditures on servicing public and municipal debt increased insignificantly from 1.0 to 1.1% of the total regional expenditures.

With the regard to expenditures under “national economy”, it is important to consider dynamics of both the entire section and subsections, because this type of expenditures is heterogeneous as opposed to most of the other expenditure sections. Examining the dynamics for certain major subsections under “national economy” in 2010, we see once again that the trends of 2009 continued developing. Expenditures allocated to support the agricultural industry continued to grow to account for 3.4% of the overall expenditures (3.1% in 2009), whereas expenditures under “road facilities” and “other national economy issues” decreased even more to 5.5% and 2.8% (against 6.0% and 3.9% in 2009), respectively.

Overall deficit of the consolidated budget of the constituent territories of the Russian Federation remained unchanged in 2010, but its scope decreased to 1.5% of the total expenditures, which was much less than in 2009 (5.3%). Examining the value of budget deficit by constituent territory, it should be noted that only 20 of 82 regions had a surplus of the consolidated regional budget at 2010 year-end. As a result, the need for borrowings remained at the subnational level. In addition, it should be noted that the need for borrowings could arise from the need for refinancing of the existing debt. Data on volumes of the public debt owed by the constituent territories of the Russian Federation in the period between 2007 and 2010 and municipal debt in 2010 is shown in *Table 20*.

Table 20

**Volumes of public debt owed by the constituent territories of the Russian Federation
in 2007 – 2010 and municipal debt in 2010 (bln RUR)**

	Debt size, bln RUR				
	as of January 1, 2008	as of January 1, 2009	as of January 1, 2010	as of July 1, 2010	as of January 1, 2011
All constituent territories of the Russian Federation	456.9	599.6	889.6	934.5	1096.0
<i>incl.:</i>					
<i>Moscow</i>	89.3	121.5	243.1	264	299.3
<i>Moscow Region</i>	92.1	156.1	163.7	151.2	146.8
Constituent territories of the Russian Federation (net of Moscow and the Moscow Region)	275.4	322	482.8	519.3	649.9
Municipalities	n/a	n/a	134.9	143.6	169.8

Data Source : Ministry of Finance of Russia, the estimates were made by the Gaidar Institute.

The data on changes in volumes of the public debt owed by the constituent territories of the Russian Federation in 2009 (an increase by RUR 290,0 bln) and in 2010 (an increase by RUR 206,4 bln) shows a slight decreased in borrowings in 2010. It is, however, the substantial decrease in growth rates of borrowings and loans in Moscow as well as of public debt in the Moscow Region in 2010 that was most responsible for the said decrease. The two above mentioned regions accounted for more than 45% of the total amount of public debt owed by

the constituent territories of the Russian Federation as of January 1, 2010. The picture would be different if we examine dynamics of volumes of the regional debt, net of Moscow and the Moscow Region. Volumes of public debt of the other constituent territories of the Russian Federation increased by RUR 167.1 bln by the end of 2010 against the level of the beginning of the year, and were a bit less (RUR 160.8 bln) in 2009. More than 78% of growth in volumes of the public debt was reported in H2 2010. It is noteworthy that balances of repaid federal loans totaled RUR 127.2 bln in 2010 for the regions (net of Moscow and the Moscow Region). By comparing the data, we can see that most of the borrowings were obtained as federal budget loans (see the next paragraph for details on federal financial assistance). In 2010, debts grew both at the regional and municipal levels. Municipal debts increased from RUR 134.9 bln as of January 1, 2010 to RUR 169.8 bln as of January 1, 2011.

To summarize, the following can be highlighted. The situation with execution of subnational budgets improved visibly in 2010. Tax revenues in the consolidated budget of the constituent territories of the Russian Federation increased in volume. However, many parameters, which describe the situation with subnational finances, were found to be much lower than the pre-recession values. Most of the Russian regions still had a deficit-ridden budget, which gave rise to the need for extra borrowings. Federal financial aid, including budget loans, kept playing an important role, like in 2009, in the provision of financial stability at the subnational level.

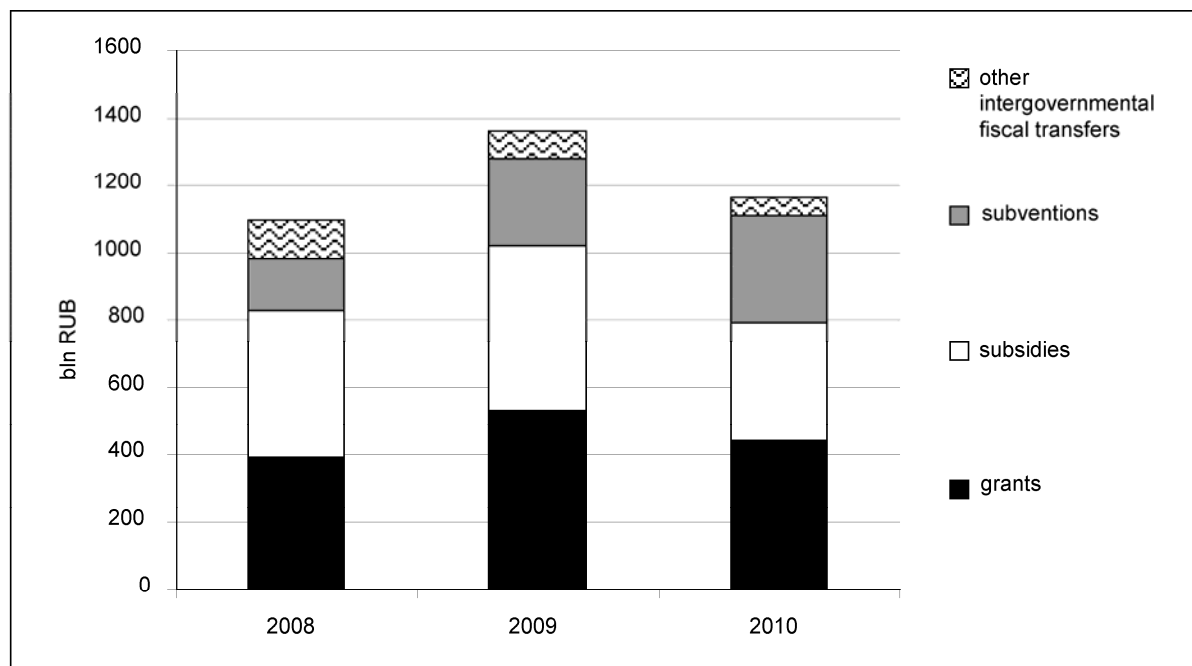
2.3.2. Financial Support from the Federal Budget

In general, the volume of funds (budget loan balances) allocated from the federal budget to the budget of the constituent territories of the Russian Federation decreased by 4.1% in nominal terms in 2010. A total volume of federal transfers decreased by 6.9% from RUR 1,480.4 bln to RUR 1,378.3 bln, whereas balances of obtained and repaid budget loans increased by 28.9% from RUR 127.5 bln to RUR 164.4 bln. It should be noted that the volume of federal budget loans allocated in 2010 to the regions remained at the level of 2009 (RUR 169.8 bln and RUR 170.0 bln, respectively). The balances increased considerably as a result of considerable decrease from RUR 43.2 bln in 2009 to RUR 5.4 bln in volumes of repaid budget loans by the regions in 2010, which may be connected with increase in the number of federal budget loans issued for a period of more than one year.

Let's examine dynamics of certain types of federal transfers (see *Fig. 15*).

All types of transfers save for subventions, which increased in nominal terms by 33.1%, decreased in 2010 against 2009. Other intergovernmental fiscal transfers decreased by 25.2% and subsidies by 22.4% decreased most against the level of 2009. Grants also decreased in volumes by 9.6%. However, if we compare the amounts of transfers to the regions with the amounts transferred in 2008, the picture would be slightly different. In general, total volume of transfers (at 2008 values) increased by 6.4% in 2010 against 2008. On the other hand, other intergovernmental fiscal transfers substantially decreased in real terms by 51.9% and subsidies by 20.3% against the level of 2008. At the same time, subventions in 2010 (at 2008 values) more than doubled subventions in 2008 (a 108.8% growth in real terms). In addition, in 2010 grants increased in real terms by 13.1% against the level of 2008.

The foregoing dynamics resulted in specific changes in the structure of transfers in the period between 2009 and 2010 (see *Table 21*).



Data Source : The Federal Treasury, the estimates were made by the Gaidar Institute.

Fig. 15. Transfers to the regions from the federal budget in 2008 – 2010 (at 2008 values).

Table 21

**Transfers to the Russian regions from the federal budget
in 2008 – 2010, in nominal terms**

	2008		2009		2010	
	mln RUR	as % of total	mln RUR	as % of total	mln RUR	as % of total
Transfer by region, total	1,094,680	100.0	1,480,385	100.0	1,378,337	100.0
Grants	390,398	35.7	578,277	39.1	522,685	37.9
including:						
fiscal capacity equalization transfers	328,648	30.0	375,485	25.4	396,996	28.8
grants on the provision of support to fiscal equalization	46,035	4.2	191,886	13.0	105,955	7.7
Subsidies	435,867	39.8	530,073	35.8	411,439	29.9
including:						
subsidies on road facilities	101,799	9.3	104,304	7.0	61,437	4.5
subsidies on agriculture	73,593	6.7	90,641	6.1	87,930	6.4
Subventions	153,170	14.0	284,440	19.2	378,650	27.5
including:						
subventions on exercise of powers for promotion of employment	37,413	3.4	77,414	5.2	87,090	6.3
subventions on the provision of housing to veterans of WWII	0	0.0	45,825	3.1	116,851	8.5
Other intergovernmental fiscal transfers	115,245	10.5	87,595	5.9	65,562	4.8

Data Source: The Federal Treasury, the estimates were made by the Gaidar Institute.

As shown in the Table, grants decreased in volumes in 2010 in nominal terms against the level of 2009 mostly due to a reduction from RUR 191.9 bln to RUR 105.9 bln in the amount of grants on the provision of support to fiscal equalization. As a result, a share of grants on fiscal equalization decreased in the total amounts of transfers from 13.0 to 7.7%, whereas a share of fiscal capacity equalization transfers increased from 25.4 to 28.8%. In general, these

changes should be regarded as positive ones, because fiscal capacity equalization transfers are allocated by using the most transparent method based on impartial factors. It is important to emphasize that decrease in volumes of grants on fiscal equalization was accompanied by a substantial growth in balances of budget loans. In general, however, the amount of grants fiscal equalization and balances of budget loans decreased by 15.4% in nominal terms from RUR 319.4 bln in 2009 to RUR 270.3 bln in 2010. The decrease reflects the above mentioned ease of tensions in subnational finances in 2010 against 2009.

A share of subventions increased considerably in the total amount of transfers in the period between 2009 and 2010, from 14.0% in 2008 to 27.5% in 2010. Growth in volumes of subventions was conditioned mostly by a consistent increase in subventions on exercise of powers for promotion of employment due to escalating tensions in the labor market, and a subvention on the provision of housing to veterans of WWII on the occasion of the V-Day 65th Anniversary¹ which was introduced in 2009. It is the latter type of subventions that was responsible for most of the growth in subventions in 2010: the subvention on the provision of housing to veterans of WWII increased from RUR 45.8 bln to RUR 116.9 bln, accounting for more than 30% of the total subventions in 2010. Furthermore, it should be noted that in 2010 housing utility subventions for specific categories of individuals increased by 17.8% from 84.8 to RUR 99.9 bln.

A share of subsidies in the total amount of transfers gradually decreased in the period between 2009 and 2010, from 39.8% in 2008 to 35.8% in 2009, to 29.9% in 2010. A visible reduction in co-financing from the federal budget as part of federal special-purpose programs and budget investments which were not included into federal special-purpose programs, was most responsible for substantial reduction in the amounts of subsidies in 2010. In general, the reduction accounted for about 35% against the level of 2009. Furthermore, subsidies to the Federal Road Agency were reduced from RUR 104.3 bln in 2009 to RUR 61.4 bln in 2010. As a result, a share of these subsidies decreased from 7.0 to 4.5% in the total amount of transfers. Subsidies on agriculture decreased too, but not that much, by 3% against the level of 2009. Nevertheless, a share of these subsidies increased from 6.1 to 6.4% against a much bigger decline in the total amount of transfers. In addition, it should be noted that a series of federal budget subsidies were discontinued in 2010, of which most relevant were:

- 1) subsidies on the provision of individuals with rent and utility subsidies (RUR 11.7 bln in 2009) ;
- 2) subsidies on compensation for a part of payment which parents pay for maintenance of their kids at public and municipal educational institutions operating under the basic pre-school general education curriculum (RUR 8,2 bln in 2009) ;
- 3) subsidies on public support to introduction of integrated modernization of education (RUR 5.3 bln in 2009) ;
- 4) subsidies on training of labor force and specialists for high-tech enterprises, which includes purchase of modern training-laboratory and training-production equipment (RUR 1.9 bln in 2009).

In addition, it is noteworthy that subsidies on purchase of motor and municipal vehicles decreased by nearly 50%, from RUR 19.7 bln in 2009 to RUR 9.96 bln in 2010. It should be noted, however, that a subsidy of RUR 1.02 bln on purchase of school buses manufactured on

¹ Pursuant to the Order of the President of the Russian Federation dd. May 7, 2008, No. 714 “On the Provision of Housing to Veterans of WWII, 1941–1945”.

the territory of the Russian Federation for general educational institutions was introduced at the same time in 2010.

In spite of decline in the total amount of subsidies in 2010, co-financing was increased for specific subsidies, including the following major subsidies :

- 1) subsidies on additional measures aimed at easing tensions in the labor market of the constituent territories of the Russian Federation (by RUR 2.9 bln or 8.2%) ;
- 2) a subsidy to the budget of the Krasnodar Territory on measures aimed at developing the infrastructure at the city of Sochi (by RUR 9.3 bln or more than 4 times) ;
- 3) subsidies on medical rehabilitation of children (by RUR 2.8 bln or more than 3 times against the level of 2009).

In general, referring to the basic parameters of transfers from the federal budget in 2010, the following can be highlighted. The trends of 2009 continued in 2010, namely increase in a share of subventions and decrease in a share of subsidies and other intergovernmental fiscal transfers in the total amount of transfers from the federal budget. Though the total volume of grants on fiscal equalization and budget loans increased in 2010, it exceeded considerably the level of 2008, which was to a large extent due to certain sustained tensions regarding the execution of the consolidated budget of the constituent territories of the Russian Federation. Increase in a share of fiscal capacity equalization transfers in the total amount of transfers from the federal budget became a positive trend in 2010.

2.3.3. Federal Law “On the Federal Budget for 2011 and Planning Period of 2012 and 2013” as Related to Allocation of Intergovernmental Fiscal Transfers to Other Budget System Levels

A total of about RUR 1,252.4 bln was scheduled for allocation to regional and local budgets in 2011, which is 9.1% less in nominal terms than in 2010. Overall federal budget expenditures are expected to increase by 5.4%. A share of intergovernmental fiscal transfers to other levels of the budget system will eventually decrease from 13.6 to 11.7% in the federal budget expenditures against 2010.

The **grants** scheduled for allocation from the federal budget in 2011 will total RUR 523.3 bln, which is almost equal to the level of 2010 (RUR 522.7 bln). In 2011, the main channel of financial aid to regional government authorities – fiscal capacity equalization transfers from **the Fund for Financial Support of the Regions (FFSR)** – is expected to be maintained at the level of 2010 (RUR 397 bln). It should be noted that the 2010 upward trend in a share of the FFSR in total amount of transfers from the federal budget is expected to continue in 2011. Under the Federal Law “On the Federal Budget for 2011–2013”, a share of fiscal capacity equalization transfers must increase from 28.8% in 2010 to 31.7% in 2011. It should be emphasized, however, that the scheduled increase in a share of the FFSR is to be reached by reducing the total amount of transfers and maintaining the volume of fiscal capacity equalization transfers at the level of 2010. Given that the Fund accounted for 73% of the intergovernmental fiscal transfers in 1999, and fiscal capacity of the Russian regions became more unbalanced since 1999, the scheduled volumes of grants from the FFSR in 2011 – 2013 seem to be insufficient if maintained at the level of 2010 (i.e. without any indexation whatsoever within three years).

Since 2005 **the Compensation Fund (CF)** has been accumulating funds to finance all of the existing in the legislation federal expenditure mandates established in an explicit form, which are financed through subventions to subnational budgets. The Federal Law “On the Federal Budget for 2011 and for the Period till 2013” provides for a material decrease in the

volume of subventions from RUR 378.7 bln in 2010 to 246.2 in 2011 or by 35% in nominal terms. Such a substantial reduction in the amount of subventions was conditioned primarily by completion of the program on the provision of housing to veterans of WWII which was financed with federal budget subventions of RUR 116.9 bln or about 30% of the total volume of subventions in 2010.

With regard to **subsidies**, the Federal Law “On the Federal Budget” provides for an increase of RUR 24.5 bln in relevant allocations to total RUR 435.9 bln in 2011 (by 5.9% in nominal terms against 2010). As a result, a share of subsidies will be increased in 2011 from 29.9% in 2010 to 34.8% in the total volume of intergovernmental fiscal transfers allocated to lower levels of power. Following are the main targets of co-financing of regional and municipal expenditures in 2011:

- government-sponsored program on the development of the agricultural industry and regulation of agricultural markets, raw material markets and food markets for 2008–2012 (22.8% of the total subsidies);
- motor road (highway) building and modernization (12.8%)¹;
- additional measures aimed at easing the tensions in the labor market of the constituent territories of the Russian Federation (6.4%);
- financing supplementary medical aid from district primary care doctors and pediatricians, general practice doctors (family doctors) (5.0%).

It should be noted that while co-financing expenditures on federal support of the agricultural industry remained one of the federal top priorities in the period between 2009 and 2010 (in 2008–2009 a share of relevant allocations accounted for about 17% in the total volume of subsidies, and increased up to 21% in 2010), **subsidies on road facilities** were substantially reduced at the onset of the economic recession (the relevant allocations in 2009 were reduced by 32.6% against the initial version of the Federal Law “On the Federal Budget for 2009”). As a result, a share of subsidies on road facilities reduced in total subsidies from 23.4% in 2008 to 19.6% in 2009 and 14.8% in 2010. These subsidies are scheduled for further reduction to eventually account for 12.8% of the total subsidies in 2011. It should be noted that the volume of federal budget subsidies on road facilities is to be reduced together with creation of a federal road fund and regional road funds. Relevant amendments have not yet been made to the federal legislation to date.

In addition, it should be noted that efficiency of **subsidies as part of the government-sponsored program on promotion of the development of the agricultural industry** and regulation of agricultural markets, raw material markets and food markets for 2008–2012 gives rise to a serious doubt. Delegation of powers to support agricultural production at the regional level may result in better support to the regions which can afford such a policy rather than those which have favorable climatic and natural conditions. This trend may be strengthened through allocation of federal budget funds in support of the agricultural industry based on the principle of cofinancing. To be more exact, more financially stable regions may benefit from such a support in their “trade wars” for agricultural markets with less financially stable regions.

In 2011, substantial volumes of funds will be allocated to implement measures aimed at easing the tensions in the labor market of the constituent territories of the Russian Federation (RUR 27.8 bln), as well as promoting the development of SMEs (RUR 16 bln). It must be

¹ These subsidies include relevant expenditures as part of federal special-purpose programs.

borne in mind, however, that it is the authorities of a constituent territory of the Russian Federation that are responsible for efficient utilization of the funds.