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The review provides a detailed analysis of main trends in Russia's economy in 2009. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; 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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□ **Institute for the Economy in Transition, 2010**

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Russia's Interbudgetary Relations and Subnational Finance in 2009

2.3.1. Subnational budgets in the grip of economic crisis

Main trends in relations between different tiers of government are mirrored in the revenue and expenditure structure of the consolidated budget of RF. *Table 1* presents data that highlight on the proportion of tax revenues and expenditures of the Subjects of the Federation in the respective indicators of Russia's consolidated budget.

Table 1

Proportion of Some Indicators of Budgets of the RF Subjects in Russia's Consolidated Budget in 1992–2009 (as %)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| 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 |
| Tax revenues less mineral payments 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 |
| 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 |

Source: the Federal Treasury, the IET calculations.

Analysis of the data of *Table 1* allows the following notes: between 1998 and 2005 the proportion of tax revenues to the RF Subjects' budgets in the consolidated budget has tumbled from 56.6% to 30.9%. The tendency has been fueled chiefly by the economic factors (specifically, the price rise for energy sources has entailed a greater influx of customs duties and mineral payments to the federal budget), rather than by reallocation of revenue sources between different tiers of the budget system. This is evidenced by the fact that the plunge in the proportion of subnational budgets in tax revenues to the consolidated budget has not been equally drastic – from 53% in 1999 to 49.1% in 2005. Between 2006 and 2007 the proportion of subnational budgets in tax revenues was on the rise due to a faster growth in revenues from taxes fixed with regional budgets vis-à-vis those fixed with the federal budget. In 2008, the proportion slid slightly, but remained on a level substantially in excess of the 2005 one, nonetheless. Meanwhile, the 2008 proportion of regional budgets in tax revenues to the consolidated budget posted a notable growth vs. the respective figure of 2007. The economic crisis has altered the relations in question. The proportion of the RF Subjects' tax revenues in the respective revenues to Russia's consolidated budget posted a dramatic growth from 33.2 to 36.6%, which can be ascribed primarily to a drastic fall in revenues to the federal budget from the mineral tax and custom duties. The proportion of regional budgets without regard to mineral payments and customs duties also was slightly up at 1.1 p.p., from 53.7% to 54.8%. This is largely determined by the steadiness of revenues from the PIT to regional budgets during the crisis period (Rb 1, 666.2bn in 2008 and 1,665.8bn in 2009).

Let us examine the situation with regard to the revenue part of the subnational budgets in a greater detail. Starting from November 2008, the economic crisis has begun intensively affecting revenues to the regional budgets. As noted in the previous review, initially, the crisis most heavily battered those subjects of RF that were more better off economically (Tyumen oblast, Orenburg Oblast, Khanty-Mansy AO, Chelyabinsk oblast, etc.), as their revenues are dependent chiefly on the financial standing of large taxpayers concentrated in the metallurgical, oil, petrochemical and some other sectors. Between November and December 2008 tax revenues to the RF Subjects' consolidated budgets shrank in nominal terms in 34 regions compared with the same period of 2007, with 15 regions suffering a sizeable (over 10%) fall in the revenues (see *Table 2*).

In the 1st quarter 2009, the economic crisis hit budget revenues of most Russia's regions: when compared with the same period of 2008, the tax revenues to the RF Subjects' consolidated budgets tumbled in nominal terms in 54 regions, with already 31 regions suffering the noted drastic 10%-plus fall in their revenues. Meanwhile, it should be noted that the situation with execution of the revenue part of the RF Subjects' budgets was particularly stretching in January and February and improved notably in March.

Between April and May 2009 the situation with execution of the revenue part of the budget remained relatively stable (compared with the 1st quarter of the year). But when compared with the same period of 2008, most Russian regions saw their tax revenues plunge. By results of the first 9 months of the year the magnitude of the fall diminished slightly; however, the number of the RF Subjects that reported a rise in their tax revenues in 2009 dropped vis-à-vis the same period of 2008 (their number proved to be smaller than the one reported by results of the 3 and 5 months of 2009). In the 4th quarter, the situation with tax revenues to the RF Subjects' consolidated budgets somewhat improved. By results of the year only 6 Subjects saw their tax revenues fall by more than 25%, while another 31 Subjects registered their rise. So, it can be argued that it was in the beginning of the year that regional budgets experienced the most serious problems with their revenue part. The situation had slightly improved by the end of the year; however, as many as 52 out of 83 RF regions saw their tax revenues fall vs. the 2008 level.

The main cause behind the rise of problems with execution of the revenue part of the RF Subjects' budgets became a fall in revenues from *the corporate profit tax*, which kicked off in the late 2008. Between November and December 2008 the said revenues to the consolidated budget of the RF Subjects plunged by 30.5% in nominal terms compared with the same period of 2007. The fall encompassed most Subjects of the Federation (65 out of 83 ones), and the negative tendency continued in the first quarter 2009, with the revenues in question slid by 35% in nominal terms vs. the same period of 2007 already in 72 regions. It should be noted that the situation with revenues from the corporate profit tax began to improve in March, but it was extremely daunting in January and February 2009. More specifically, in three regions (Republic of Sakha-Yakutiya, Astrakhan oblast and Yamal-Nenetsky AO) the amount of refunds of the corporate profit tax even exceeded the volume of the respective revenues. In April and May 2009, revenues from the corporate profit tax were substantially (roughly two-fold) lower than the respective figures of 2008, i.e. the situation continued to aggravate. While it somewhat improved in the second half of the year, the problem remained very pressing, nonetheless. By results of the year revenues from the corporate profit tax to the RF Subjects' consolidated budget shrank by 39% compared with the 2008 figures, with the fall registered in 67 regions.

Table 2

**Classification of Russia's Regions by Change in Tax Revenues
to Their Consolidated Budgets**

| The number of regions wherein the change in tax revenues accounted for: | November- December 2008 to the same period of 2007 | January- February 2009 to the same period of 2008 | January- March 2009 to the same peri- od of 2008 | January-May 2009 to the same period of 2008 | January- September 2009 to the same period of 2008 | January- December 2009 to the same period of 2008 |
|--|--|---|---|--|--|---|
| Fall over 25% | 3 | 15 | 7 | 11 | 10 | 6 |
| Fall between 10 and 25% | 12 | 24 | 24 | 24 | 19 | 19 |
| Fall less than 10% | 19 | 29 | 23 | 21 | 31 | 27 |
| Growth | 48 | 14 | 29 | 27 | 23 | 31 |

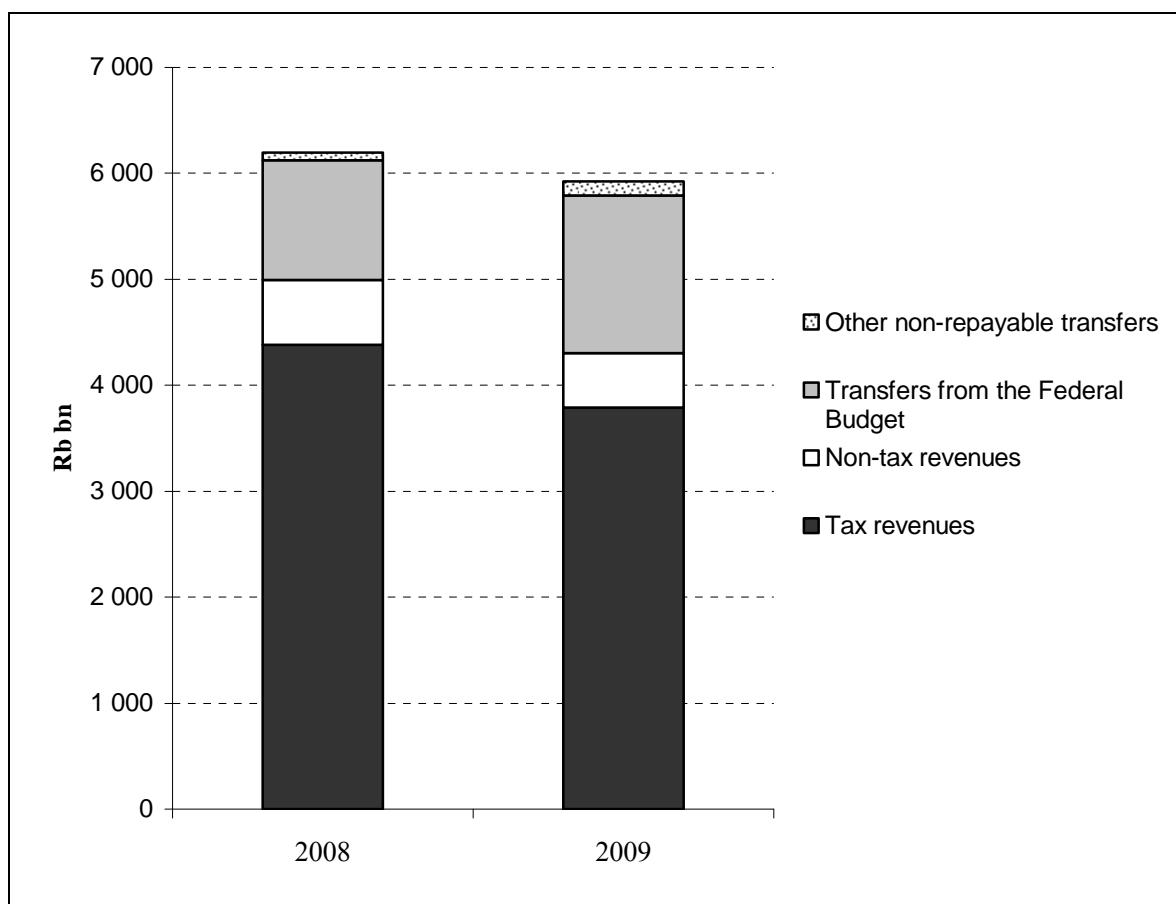
Source: the Federal Treasury, the IET calculations.

By contrast, revenues from *the personal income tax* across the country on the whole proved to be far more stable. In the first quarter 2009 they posted a 5% growth in nominal terms vis-à-vis the first quarter of 2008. But some Subjects of the Federation (Chelyabinsk, Yaroslavl, Kemerovo, Orel, Sverdlovsk oblast) saw their considerable (by more than 5%) plunge. The increase in revenues from the PIT can be partly ascribed to pay rises to budget employees. But the situation aggravated shortly afterwards. As already noted, overall, the 2009 PIT-based revenues remained at the 2008 level, but region-wise the situation appears far less unambiguous. In 36 regions revenues from PIT were down, with 7 regions reporting their 10%-plus fall¹.

Overall, the 2009 revenues to the RF Subjects' consolidated budget fell by 4.4% in nominal terms vs. their 2008 level. That said, different components of the revenues demonstrated a multidirectional dynamic, and, consequently, the revenue structure underwent notable transformations (see *Fig. 1*).

The 2009 tax revenues to the RF Subjects' consolidated budget shrank by 13.5% in nominal terms, while their proportion in the aggregate revenues to regional budgets slid from 71% to 64%. Non-tax revenues also dropped by 15.4%, and their proportion slid from 9.8% to 8.7%. Meanwhile, transfers out of the federal budget grew by 31.4% in nominal terms, with their proportion in the aggregate revenues soaring from 18 to 25%. So, in the conditions of crisis, the role of the federal aid grew substantially. Transfers from the federal budget have formed a cushion, thanks to which regions were able to more painlessly pass the peak of the economic crisis (more on federal transfers below).

¹ Republic of Dagestan, Chelyabinsk, Yaroslavl, Sverdlovsk, Kemerovo oblasts, Republic of Chuvashia, Perm-sky Krai



Source: the Federal Treasury, the IET calculations.

Fig. 1. Revenues to the Consolidated Budget of the RF Subjects in 2008–2009, by Components

The expenditure part of the RF Subjects’ consolidated budget also underwent substantial modifications. It should be noted that the year 2009 saw interruption of the previous 2007-08 trend to growth of regional expenditures in the consolidated budget of RF (see *Table 1*). The proportion of regional expenditures tumbled from 49.2% in 2008 to 43.4% in 2009. This situation emerged due to the fact that expenditures of the RF Subjects’ consolidated budget remained practically at their 2008 level (with their increase accounting for a meager 0.04%), while the federal budget expenditures (less transfers to regions) posted a 26% increase compared to the respective figure of the prior year.

But given that the aggregate volume of expenditures has remained unchanged; their 2009 structure underwent certain transformations (see *Table 3*).

The data of *Table 2* evidence that it was regional transfers by sections “Social policy” and “Interbudgetary transfers” (this concerns largely transfers to the CMI Territorial Funds), as well as those on servicing the public and municipal debts, that posted the greatest increase. The rise in the debt servicing expenditures was fueled by more intense subnational borrowings in 2009, while the increase in expenditures on the social policy was driven by greater expenditures on implementation of the government employment policy (funded with subventions out of the federal budget), among other factors.

Table 3

**Expenditure Structure of the Consolidated Budget of the RF Subjects
in 2008–2009 (as %)**

| | 2008 | 2009 | Change (p.p.) |
|---|------------|------------|---------------|
| General public administration matters | 7.1 | 7.3 | 0.2 |
| <i>Including servicing the public and municipal debts</i> | <i>0.6</i> | <i>1.0</i> | <i>0.4</i> |
| National security and law enforcement activities | 4.1 | 3.9 | –0.2 |
| National economy | 19.6 | 18.1 | –1.5 |
| Housing and utilities sector | 16.3 | 13.6 | –2.7 |
| Environment | 0.3 | 0.3 | –0.1 |
| Education | 20.8 | 21.5 | 0.7 |
| Culture, motion picture industry, and mass media | 3.5 | 3.4 | –0.1 |
| Healthcare and sport | 12.7 | 12.1 | –0.6 |
| Social policy | 12.2 | 15.3 | 3.1 |
| Interbudgetary transfers (IBT) | 3.3 | 4.4 | 1.1 |

Source: the Federal Treasury, the IET calculations

The greatest decrease in the proportion in the aggregate expenditures was noted across sections “Housing and utilities sector” and “National economy”, with expenditures on the former being cut in nominal terms by 16.2%, while those on the national economy - curtailed by 8% vis-à-vis the respective figures of 2008. The cuts in the housing and utilities sector occurred largely due a 23% fall in capital investment therein. As concerns support of the national economy, it is important to examine the expenditure dynamic across its subsections. The cuts in expenditures on the national economy can be ascribed primarily to a 3.8% curtailing of the funding of the road construction, maintenance and repair sector (*aka* “the road sector”), which in 2008 accounted for 37% of the aggregate expenditures on this particular sector. Meanwhile, expenditures on the subsection “General economic expenditures” increased substantially (1.7 times). This can be attributed primarily to a greater volume of funding of measures on alleviating the stretching situation on the labor market. As well, expenditures on the support to the agrarian sector were also up (by 8.7%). It should be noted that all the three expenditure directions in the sphere of national economy are funded with subsidies out of the federal budget.

In all, speaking of the dynamic and structure of expenditures of the 2009 RF Subjects’ consolidated budget, the following phenomena are worth referencing to: it was capital expenditures that were trimmed most intensively, while expenditures on servicing the public and municipal debts, as well as expenditures on directions that are (co-) financed out of the federal budget posted a substantial increase.

Table 4

Volume of the Public Debt of the Subjects of RF in 2008–2009

| | Volume of the public debt, as Rb bn: | | | | | | |
|--|--------------------------------------|-------------------|---------------------|-------------------|---|-------------------|--|
| | As of 01.01.08 | As of 01.01.09 | Increase in 2008 | As of 01.07.09 | Increase in the 1 st half 2009 | As of 01.12.09 | Increase over the 11 months 2009 |
| All RF Subjects | 456.9 | 599.6 | 142.7 | 725.4 | 125.8 | 787.7 | 188.1 |
| The city of Moscow | 89.3 | 121.5 | 32.2 | 208.1 | 86.5 | 232.3 | 110.8 |
| Moscow oblast | 92.1 | 156.1 | 63.9 | 164.6 | 8.6 | 158.1 | 2.0 |
| RF Subjects (less the city of Moscow and Moscow oblast) | 275.4 | 322.0 | 46.5 | 352.7 | 30.7 | 397.3 | 75.3 |

Source: the RF Ministry of Finance, the IET calculations.

With a drastic decline in tax and non-tax revenues to the regional budgets in 2009, the RF Subjects have renewed their pro-active borrowing policy (see *Table 4*).

As evidenced by the data of *Table 4*, the aggregate volume of borrowings over the 11 months of 2009 proved to be up 32% vs. the respective figure of the whole 2008. But worth a particular notice is the fact that 59% of the borrowings falls on the city of Moscow alone. The Moscow mayor office nearly doubled the city's debt over the period in question. Other Russian regions proved to be more conservative in this regard, but as of December 1, 2009, their aggregate debt volume posted a 23% growth compared with the respective figure as of January 1, 2009. The modification of the format of presentation of the RF Subjects' public debt by the RF Ministry of Finance allows tracking down the dynamic of borrowings by their individual kinds only over the first half 2009. That said, just as much as 41% of the volume of the increase of the debt over the 11 months of 2009 (less the city of Moscow) falls on the first half-year. But the respective data give a certain idea of the structure of the RF Subjects' borrowings in 2009, nonetheless (*Table 5*).

Table 5

Volume of the Public Debt of the Subjects of the Federation by Kinds of Liabilities in the First Half of 2009

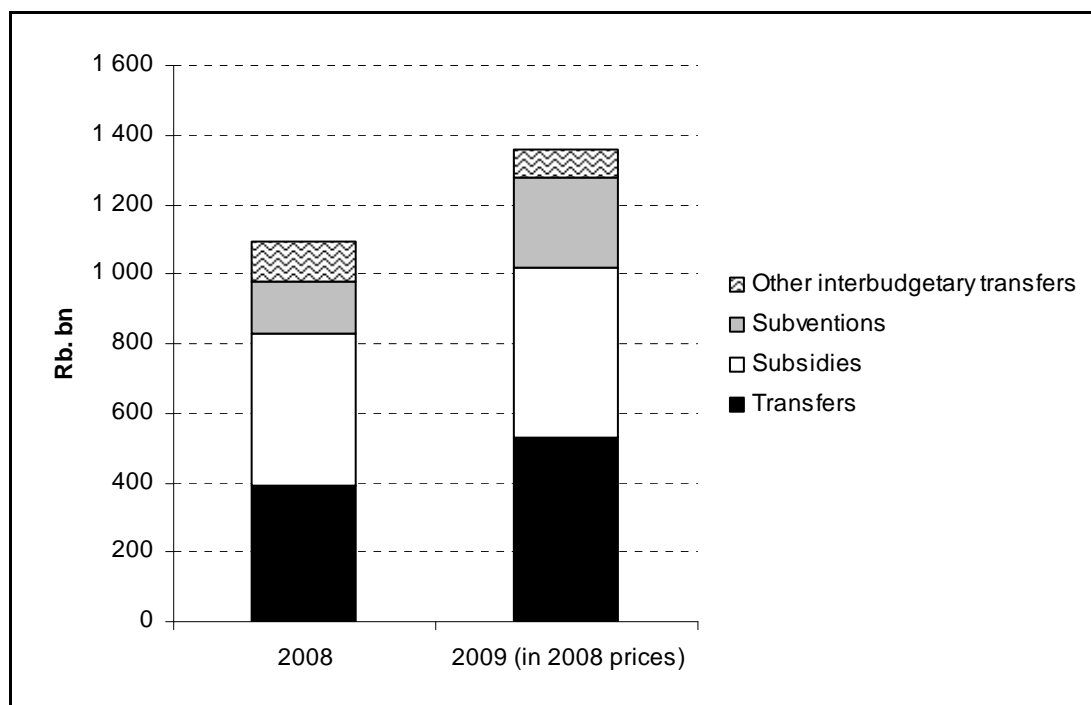
| | Total, across the RF Sub- jects | including: | |
|--------------------------------------|---------------------------------------|--------------------|--|
| | | The city of Moscow | Across the RF Subjects (without regard to the city of Moscow) |
| Loans to the RF Subjects | | | |
| as of 01.01.2009, Rb bn | 268.9 | 81.5 | 187.4 |
| as of 01.07.2009, Rb bn | 323.9 | 152.1 | 171.7 |
| change (+/-), Rb bn | 55.0 | 70.6 | -15.7 |
| increase rate % | 20.4 | 86.7 | -8.4 |
| Loan agreements and contracts | | | |
| as of 01.01.2009, Rb bn | 166.3 | 32.4 | 133.9 |
| as of 01.07.2009, Rb bn | 180.7 | 34.2 | 146.5 |
| change (+/-), Rb bn | 14.4 | 1.8 | 12.6 |
| increase rate % | 8.7 | 5.6 | 9.4 |
| Government guarantees | | | |
| as of 01.01.2009, Rb bn | 123.2 | 3.2 | 120.0 |
| as of 01.07.2009, Rb bn | 143.8 | 17.2 | 126.6 |
| change (+/-), Rb bn | 20.6 | 14.0 | 6.6 |
| increase rate % | 16.7 | 436.9 | 5.5 |
| Budget loans | | | |
| as of 01.01.2009, Rb bn | 40.8 | 4.5 | 36.3 |
| as of 01.07.2009, Rb bn | 76.8 | 4.5 | 72.2 |
| change (+/-), Rb bn | 36.0 | 0.0 | 35.9 |
| increase rate % | 88.2 | 0.9 | 99.0 |
| Other debt liabilities | | | |
| as of 01.01.2009, Rb bn | 0.4 | - | 0.4 |
| as of 01.07.2009, Rb bn | 0.3 | - | 0.3 |
| change (+/-), Rb bn | -0.1 | - | -0.1 |
| increase rate % | -19.3 | - | -19.3 |
| Liabilities, total | | | |
| as of 01.01.2009, Rb bn | 599.6 | 121.5 | 478.1 |
| as of 01.07.2009, Rb bn | 725.4 | 208.1 | 517.3 |
| change (+/-), Rb bn | 125.8 | 86.6 | 39.2 |
| increase rate % | 21.0 | 71.3 | 8.2 |

Source: the RF Ministry of Finance, the IET calculations.

It should be first noted that the volume of bonded loans across Subjects of RF (less the city of Moscow) in the first half 2009 did not post any growth, but even slid by 8.4%. This can be ascribed to several factors. First, the luxury to attract loans on the security market is not within an immediate reach of all the Subjects of the Federation, as there exist technical complexities and the necessity to meet certain criteria. For example, as of late 2009, it was only 19 Subjects that had earned an S&P rating. Second, the overall situation on the financial market had drastically aggravated since the second half 2008. That resulted in higher lending rates and, fairly frequently, the impossibility for second-class borrowers to place their papers. Yet another peculiarity of the RF Subjects' borrowings in 2009 became a growing role of budget loans disbursed from of the federal center's pool. By results of the first half 2009 the budget loans have increased nearly 3-fold compared with banks' commercial loans (on the whole, across the RF Subjects, less the city of Moscow). Thus, in the conditions of a substantial fall of tax and non-tax revenues to regional budgets, and a substantial worsening of conditions of borrowings and an increase of lending rates, budget loans from the federal center, together with transfers, formed one of the pivotal financial pools for the RF Subjects' budgets.

2.3.2. Financial aid from the federal budget

In all, the 2009 volume of financial resources the federal budget transferred to the RF Subjects' ones rose by 34%. The biggest increase was posted by subventions (up 71%) and budget loans whose volume was more than 10-fold greater than the respective figures of 2008. Transfers increased by 36% and subsidies – by 12%. By contrast, the volume of other extrabudgetary transfers shrank by 30%. All that resulted in some transformation of the structure of federal transfers to regions (see *Fig. 2*).

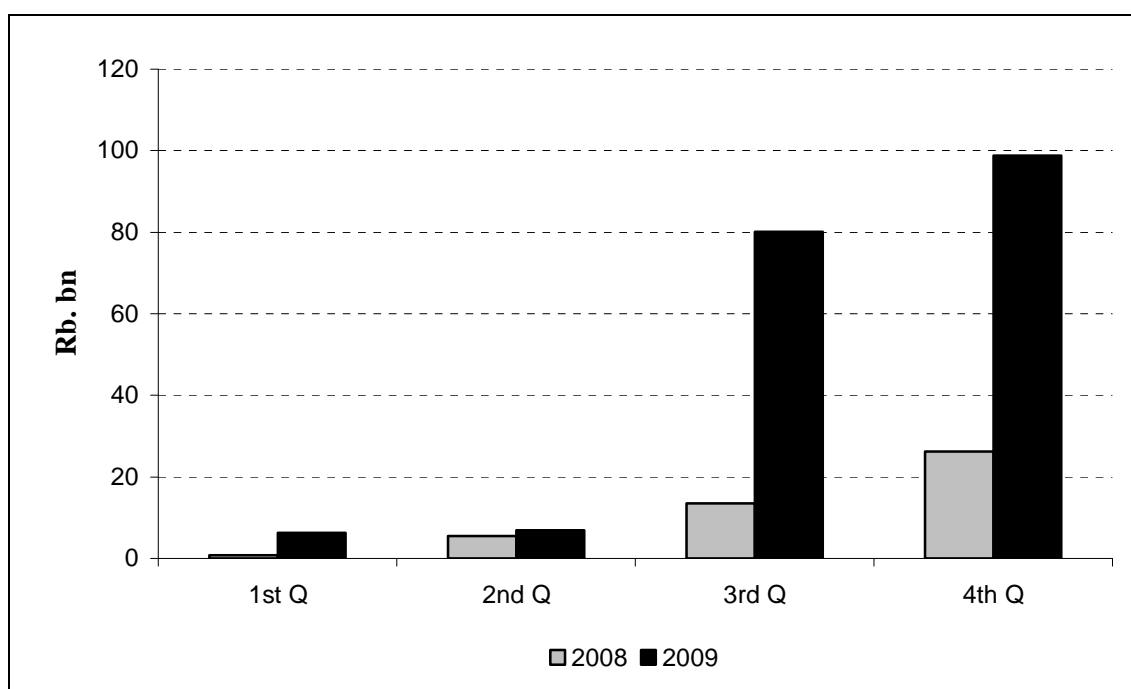


Source: the Federal Treasury, the IET calculations.

Fig. 2. Transfers to Regions out of the Federal Budget in 2008–2009

On the whole, it was the proportion of subventions in the aggregate amount of federal transfers that posted the greatest pace of growth – from 14% in 2008 to 12.9% in 2009. The proportion of transfers was on the rise, too, - from 36% to 39%. In contrast, the proportion of subsidies slid from 40 to 36%, while the one of other interbudgetary transfers plunged by 4.6 p.p., to 5.9% of the aggregate amount of transfers.

Let us examine individual kinds of transfers out of the federal budget in a greater detail (see *Table 5* at the end of the present section). As already noted, their 2009 volume surged in real terms by 36% vs. the respective figures of the prior year. But the growth was fueled primarily by a substantial increase in transfers on getting the regional budgets balanced. While transfers on equalizing the budget sufficiency out of the Federal Fund for Financial Support of Regions increased in real terms just by 4.6%, the volume of the “balancing” transfers soared 3.8 times compared with 2008. Meanwhile, the proportion of the “balancing” transfers in the overall volume of transfers rose from 4% in 2008 to 13% in 2009. It should also be noted that a drastic increase in such transfers to regions fell on the second half 2009 (see *Fig. 3*).



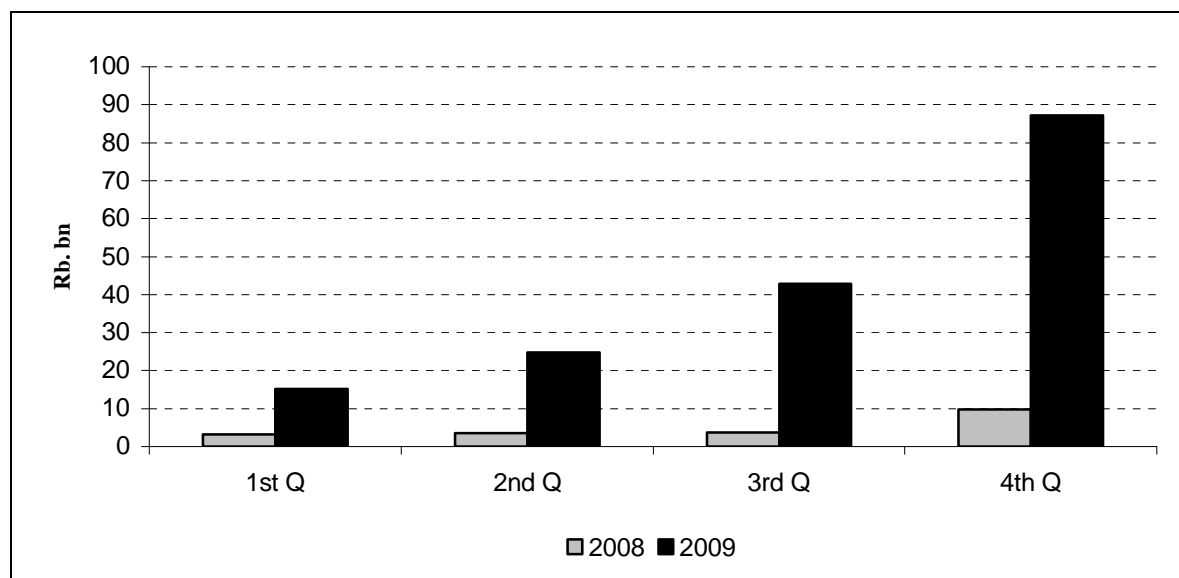
Source: the Federal Treasury, the IET calculations.

Fig. 3. Transfers on Support of the Regional Budgets’ Balance in 2008–2009

On the one hand, the increase in transfers on getting the regional budgets balanced is partially justified by grave challenges the subfederal budgets were facing in 2009. On the other hand, as it was repetitiously noted in the earlier reviews, this particular kind of transfers forms one of the most opaque interbudgetary relations instruments and one of main sources of soft budget constraints in the national system of federalism.

Whilst considering the dynamic of budget loans disbursed out of the federal budget to regions in 2009, it is worth noting that it appears similar to the dynamic of the “balancing” transfers (see *Fig. 4*). Their biggest amounts once again fell on the second half-year, with those allocated in the 4th quarter accounting practically for a half of the annual sum of the re-

spective appropriations. It should be emphasized that since 2009 budget loans have become available for the term of up to three years. In 2009, the federal center extended a total of Rb. 170bn in budget loans vis-à-vis Rb. 20 bn disbursed in 2008. As a result, budget loans accounted for nearly 8% of the aggregate amount of financial aid to the RF Subjects. That said, the 2009 “balancing” transfers and budget loans combined were worth a total of Rb. 319bn, or 20% of the amount earmarked to the regional budgets (in 2008, the respective figure was just 5.2%).



Source: the Federal Treasury, the IET calculations.

Fig. 4. Loans Disbursed out of the Federal Budget in 2008-2009

As noted above, the 2009 volume of subventions out of the federal budget also posted a substantial growth vs. the one of 2008 (up by Rb 136.2bn). The greatest growth rates were registered across the following directions:

- On exercise of the Russian Federation’s powers in the area of assistance to the population employment, including expenditures on the exercise of these powers (up by Rb 40bn, or more than twice);
- On provision of individual categories of citizens with housing, as per federal act of January 12, 1995 №5-FZ “On veterans” (up by Rb 31 bn, or more than thrice);
- On payment for housing and utilities to certain categories of citizens (up by Rb 18.4bn, or by 28%);
- On delivery to individual categories of citizens a social service in the form of an extra free medical assistance with regard to provision of medicines, medical items and specialized medical food products for disabled children (up by Rb 6.8bn, or by 27%).

So, it is the ‘anti-crisis’ subventions allocated to fund the employment measures and those on provision of housing to the GPW veterans due to celebration of the 65th anniversary of the victory in the Great Patriotic War (in compliance with presidential decree of May 7, 2008, № 714 (“On provision of housing to veterans of the Great Patriotic War 1941-1945”) that posted the highest growth rates.

The volume of subsidies out of the federal budget was increased in nominal terms by Rb 104bn, or up by 20% compared with 2008. But by some directions the funding was curtailed substantially, while by other ones it was increased, thus giving rise to new kinds of subsidies of which the biggest ones became:

- Subsidies on implementation of additional measures aimed to mitigate the tension on labor markets of the RF Subjects (Rb 35.6bn);
- Subsidies on procurement of motor vehicles and communal equipment (Rb 19.7bn).

It was subsidies on the following directions that posted the greatest increase:

- On the government support to small- and medium-sized businesses, including agrarian (farming) enterprises (by Rb 15bn, or more than five-fold) ;
- On the government support of the agrarian sector (by Rb 21.4bn, or up 37%).

In parallel with that, cuts were made across a string of subsidies. They were most sizeable by the following directions:

- Subsidies on the road construction, maintenance and repair works not included in the federal target programs (Rb 12.6bn, or down 37%);
- Subsidies for allocation of sites with communal infrastructure for the purpose of house construction (by Rb 7bn, or down 90%).

2.3.3. Modifications in the federal law in the area of interbudgetary relations and subnational finance in 2009.

The challenges Russia's budget system has been facing between late 2008 and 2009 in the conditions of economic crisis have required certain amendments to the federal legislation, primarily to the Budget Code of the Russian Federation. Main modifications introduced with federal act № 310-FZ of December 30, 2008, "On introducing amendments to the Budget Code of RF and federal act "On introducing amendments to the Budget Code of RF with regard to regulation of budgeting and bringing individual legislative acts of RF in consistency with the budget law of RF" were analyzed in our 2008 review. But certain amendments were introduced in a number of articles of the Budget Code of RF in 2009, too.

More specifically, on April 9, 2008, federal act № 58-FZ "On introducing amendments to the Budget Code of RF and individual legislative acts of RF", which has modified a number of clauses of the Budget Code of RF, was promulgated.

First, the amendments concerned Art. 92.1 with regard to the provision that sets a cap on the amount of an RF Subject's budget deficit equaling 15% of the approved aggregate volume of revenues to the regional budget without regard to unrequited revenues. This provision was softened already in act № 310-FZ – the RF Subjects were permitted to exceed the said cap by the sum of revenues from sales of stock and other forms of participation in capital, as well as by diminishing balances on accounts by accounting the regional budget's funds. Act № 58-FZ allowed an excess of the capped level of budget deficit by the amount of the balance of budget loans out of the federal budget. In contrast with the previous amendments, the effect of this provision is limited in time, with 1 January 2013 as the deadline. In a similar fashion, local self-governance bodies were allowed to exceed the cap rate of the municipal budget deficit (10%) by the balance of budget loans out of the federal budget. In addition, requirements of Art. 107 that concern the ultimate size of the RF Subject (municipal entity's) debt were softened, too, and now it can exceed the cap set by the Budget Code of RF by the size of budget loans attracted from other tiers of the budget system.

Secondly, caps which Art. 139.1 set on the amount of other interbudgetary transfers provided from the RF Subject's budget to local budgets, were modified, too. The volume of other IBTs may exceed 10% of the aggregate volume of transfers (les subventions) by the amount of transfers on support of measures on getting local budgets balanced.

Certain modifications were likewise introduced into clauses of the Budget Code of RF upon promulgation of federal act № 192-FZ of July 19, 2009 "On introducing amendments to the Budget Code of RF and Art. 45 of the federal act "On the Central Bank of the Russian Federation (Bank of Russia)". The act suspended the effect of a string of clauses of the BC of RF until January 1, 2010:

- the effect of clauses of Art. 53, 59 and 64 that require that acts affecting revenues to the budget system of RF should be promulgated prior to submission of draft budgets of the respective tier of government;
- for the year 2009 the timelines stipulated in Art. 131 and 133 were shifted for a month – the clauses hold federal agencies to complete until July 20 a check-up of original data necessary for allocating transfers on equalization of budget sufficiency and subventions for the next financial year; as well, the said provisions prohibited introduction any alterations into the data afterwards. For the year 2009 the timeline was shifted to August 20.

It is equally important to pay attention to the joint letter by the RF Ministry of Finance (№06-03-06) and the Federal Treasury (№42-7.4-05.5.0-251) of May 7, 2009, which clarifies procedures of use of balances of subsidies and subventions out of the federal budget to bridge the regional budgets' temporary cash gaps in the course of a financial year. The document reads that such a use of balances of federal funds does not conflict with provisions of the federal law in the event it does not result in growth in payables by expenditure directions, which should be funded at the expense of the said target transfers.

2.3.4. The federal act "On the federal budget for 2010 and the period through 2012 with regard to earmarking interbudgetary transfers to other tiers of the budget system".

The total amount of funds planned for transferring to regional and local budgets in 2010 roughly accounts for Rb 1,129bn. In nominal terms, this is down by 12.9% vs. the amount provided for by the act on the 2009 federal budget. That said, aggregate expenditures out of the federal budget should rise insignificantly in nominal terms (by 0.42%). Consequently, the proportion of interbudgetary transfers to other tiers of the budget system in the federal budget expenditures should fall from 13.2% in 2009 to 11.4%. Given that in late 1990s the proportion of transfers from the FFSR alone would account for 14% of the federal budget expenditures, and main revenue sources now concentrate in the federal budget, the exercise of cutting back the proportion of interbudgetary transfers to other tiers of the budget system in the federal budget expenditures can be questioned. But in all likelihood the problems with funding the pension system have left no room for maneuver for the government.

It should also be noted that the interbudgetary transfers system has remained a complex and confusing one. In a developed federative state, as a rule, there exist 1-3 largest transfers from the federal budget to territorial ones and 3-15 smaller size transfers. In Russian Federation, in compliance with the act "On the federal budget for 2010 and the period through 2012", the number of various transfers is over 87 (4 ones – in sub-section on transfers, 43 – in sub-section on subsidies, including the federal target programs, 21 – in sub-section on subventions, and 19 transfers – in sub-section on other interbudgetary transfers). The question is,

whether such a system is efficient. By analogy with taxation, the number of transfers should be acceptable for their efficient administration. The volume of financing by 35 directions does not exceed Rb 1bn, which means that funds earmarked to a Subject of the Federation by a string of directions can make up dozens or hundreds of thousands of Rubles. Clearly, given the target nature of most directions (subsidies and subventions), the costs associated with evaluation of the target nature of use of the expenditures can outweigh benefits from such appropriations. It appears necessary to conduct a thorough examination of the division of powers between the federal center and regions in order to fully assign a series of powers to regions and to return a part of them to the Federation's level.

An additional way to solve the problem of existence of a great number of minor target interbudgetary transfers and the need to improve the quality of management of allocated financial resources is their consolidation into block transfers (consolidated subsidies and subventions). The bottom line is that such block transfers give a possibility to spend financial resources consolidated into an interbudgetary transfer on several directions. Meanwhile, the level of government out of whose budget such bloc transfers are earmarked can set both the formula of their allocation and conditions of their spending by each direction of financing. The level of government that receives the bloc transfer in turn can on its own select proportions of use of the earmarked funds by each direction included in the bloc transfer.

The principal vehicle of financial aid to regional governments – that is, transfers on equalization of their budget sufficiency out of the **Fund for Financial Support of Regions** – will grow by 6% (vs. the 2009 figures) and account for Rb 397bn. It should be noted that the year of 2010 should see next attempt to overcome the tendency to contraction of the proportion the Fund holds in the overall volume of interbudgetary transfers – according to the 2010 draft budget, the FFSR's proportion in interbudgetary transfers to other levels of the budget system should grow up to 35% compared with 24% in 2009. But it is worth noting a huge gap between an original version of the budget and its ultimate execution. Sectoral ministries, as a rule, succeed in lobbying for a greater amount of subsidies and other interbudgetary transfers; meanwhile, the aggravation of the situation with regional finance triggers the growth in the “balancing” transfers and budget loans (should a budget loan be disbursed for the term of 3 years under the interest of $\frac{1}{4}$ of the refinancing rate, it in many ways becomes a substitute for a “balancing” transfer); by contrast, calculated by a certain formula, the volume of FFSR remains unchanged through the end of the year. It seems to us, while considering all kinds of interbudgetary transfers, priority should be given to FFSR, as its structure matches the best international practices and its funds are allocated following relatively transparent procedures.

Since 2005 the **Fund for Compensations** has accumulated resources on financing all the legislatively set, in an explicit form, federal expenditure mandates. The draft federal budget for 2010 and though 2012 provides for some growth in the proportion of the FC in interbudgetary transfers to other tiers of the budget system (from 17.6% in 2009 to 20.7% in 2010). The surge in subventions in interbudgetary transfers is conditioned by the “rigidness” of these obligations. The federal center, as a rule, has to index the obligations by the inflation rate.

With regard to **subsidies**, the draft 2010 budget projects their Rb 50.4bn decrease in nominal terms, down to Rb 356bn (by 14.6% compared with 2009). The main 2010 expenditure avenues in this regard are:

- the state program of development of the agrarian sector and regulation of agrarian markets, raw materials and foods for 2008-2012 - 24.7% of the aggregate amount of subsidies;

- implementation of additional measures aimed to alleviate the problems on the RF Subjects' labor markets – 10.5% of the aggregate amount of subsidies;
- the federal target program “The economic and social development of the Far East and Trans-Baikal region for the period through 2013” – 10.1% of the aggregate amount of subsidies;
- financial provision of delivery of an additional medical assistance by local physicians, pediatricians, and general physicians (family doctors) – 6.1% of the aggregate amount of subsidies.

The crisis has introduced substantial changes into the list of priority directions co-financed out of the federal budget. More specifically, subsidies for modernization of the transportation system were axed dramatically (by Rb 60.6bn), albeit such cuts may not always be recognized as a justifiable move. The fact of the matter is, subsidies out of the federal budget on the road sector and the federal target program “Modernization of Russia’s transport system (2002-2010)” (currently – the federal target program “Development of Russia’s transport system (2010-2015)”) have a great social importance from the perspective of securing the country’s territorial and economic space and the population’s spatial mobility. The respective obligations with regard to implementation of huge road-building repair and maintenance projects are fairly large, while in most cases subfederal (regional and local) budgets cannot fund them without a federal center’s contribution. Hence, it appears appropriate to provide for an increase in appropriations on road construction for the sake of creation and development of urban agglomerations. As evidenced by experiences of developed and emerging nations¹, an economic crisis is the right time for public investment in infrastructure.

Meanwhile, the volume of subsidies on support of the agrarian sector will be increased unjustifiably (by nearly Rb 21.5bn). The transfer of powers to support the agrarian sector to the regional level results in a situation when the support is rendered most intensively in regions that enjoy the greatest financial capacity to pursue such a policy, rather than in those that have the most favorable natural and climatic conditions. Earmarking resources from the federal budget for these purposes on the co-financing principles just intensifies the tendency. More specifically, it results in backing the better-off financially regions in their “trade wars” with weaker counterparts for agrarian markets. That is why efficacy of such subsidies raises serious doubts. The problem can be resolved by centralizing the subsidies at the federal level along with minimizing regional expenditures on this direction. In parallel with this, the Federation should corroborate its role in financing expenditures on social development of rural territories.

Considerable resources are earmarked on implementation of measures aimed to diminish the stretching situation on the RF Subjects’ labor markets and jolt small businesses; however, efficacy of the use of such funds greatly depends on performance of the RF Subjects’ agencies.

Overall, it can be noted that the federal act “On the federal budget for 2010 and for the period through 2012” has preserved a whole string of substantial challenges typical of Russia’s interbudgetary relations system, namely:

- 1) an insufficient volume of the FFSR and an unjustifiably low share of transfers in the aggregate volume of interbudgetary transfers;

¹ For more details, see: A. Siluanov, V. Nazarov – Vzaimodeystviye federalnogo tsentra I regionov pri provedenii antikrizisnoy politiki: mezhdunarodny opyt/Voprosy ekonomiki № 9, 2009

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- 2) a fairly big number of subventions (including minor ones in particular), which compels one to question the efficacy of the current system of division of expenditure powers between different tiers of government;
- 3) an excessive number of subsidies and an insufficiently transparent and efficient system of their allocation.

Table 5

Financial Aid out of the Federal Budget to Consolidated Budgets of Subjects of the Federation in 1992–2009 (as % of GDP)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|--|-------------|------------|------------|------------|------------|------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. Financial aid to budgets of other levels | | | | 1.8 | 2.3 | 2.5 | 1.6 | 1.18 | 1.43 | 1.79 | 2.2 | 1.94 | 1.7 | 1.65 | 1.52 | 1.79 | 1.89 | 3.04 |
| 1.1. Federal target programs as well as subsidies to RF Subjects on support of the agrarian sector, water-economic measures, support of small-sized entrepreneurship, rehabilitation of children | | | | | | | | | | | | | | 0.05 | 0.15 | 0.39 | 0.54 | 0.62 |
| 1.2. Fund for co-financing of social expenditures | | | | | | | | | | | 0.15 | 0.11 | 0.04 | 0.12 | 0.11 | 0.10 | 0.09 | 0.12 |
| 1.3. Fund for financial support of regions, including transfers on equalization of the budget sufficiency level | 0 | 0 | 0.36 | 1.17 | 1.04 | 1.22 | 1.12 | 0.99 | 0.96 | 1.14 | 1.36 | 1.3 | 1.05 | 0.88 | 0.94 | 0.79 | 0.79 | 0.96 |
| state support of the "Northern Supplies" | | | | | | | | | 0.06 | 0.08 | 0.08 | 0.07 | – | – | – | – | – | – |
| transfers at the expense of the VAT | 0 | 0 | 0 | 0.31 | 0.36 | 0.36 | 0.12 | – | – | – | – | – | – | – | – | – | – | – |
| 1.4. Transfers and subventions, including: transfers on support of measures on provision of balance of budgets | 0 | 0.02 | 0.09 | 0.06 | 0.09 | 0.13 | 0.1 | 0.06 | 0.15 | 0.54 | 0.28 | 0.29 | 0.27 | 0.36 | 0.21 | 0.31 | 0.22 | 0.59 |
| 1.5. Resources of the Fund for reforming regional and municipal finance | | | | | | | | | | 0 | 0.01 | 0.01 | 0.01 | 0 | 0.01 | 0.01 | 0.01 | 0.004 |
| 1.6. Other free and non-repayable transfers (subsidies and subventions) | | | | | | | | | | | 0.01 | 0.01 | 0.01 | 0.01 | 0.08 | 0.17 | 0.19 | 0.42 |
| 1.7. The regional development financing fund | | | | | | | | | 0.03 | 0.05 | 0.1 | 0.1 | 0.15 | 0.01 | 0.01 | 0.02 | 0.02 | – |
| 1.8. Resources transferred by mutual settlements | 0.61 | 1.95 | 2.54 | 0.42 | 0.81 | 0.43 | 0.36 | 0.14 | 0.28 | 0.05 | 0.2 | 0.14 | 0.12 | 0.01 | 0.05 | 0.02 | – | – |
| 1.9. Loans and budget credits less those paid off to other tiers of the public administration * | 0.09 | 0.03 | 0.02 | 0.04 | 0.23 | 0.64 | –0.03 | –0.1 | –0.08 | 0.02 | 0.09 | –0.01 | –0.02 | –0.03 | –0.04 | –0.01 | 0.03 | 0.33 |
| 2. Fund for compensations | | | | | | | | | | 0.37 | 0.38 | 0.36 | 0.34 | 0.17 | 0.30 | 0.43 | 0.51 | 0.80 |
| 3. Other interbudgetary transfers, of which: State support to the road sector** | | | | | | | | 0.18 | 0.11 | 0.4 | 0.45 | 0.54 | 0.35 | 0.33 | 0.34 | 0.36 | 0.27 | 0.22 |
| | | | | | | | | 0.18 | 0.11 | 0.27 | 0.27 | 0.31 | 0.22 | 0.13 | 0.15 | 0.17 | 0.08 | 0.07 |
| Funds transferred to budgets of other levels of government, total | 1.49 | 2.7 | 3.4 | 1.8 | 2.3 | 2.5 | 1.6 | 1.36 | 1.54 | 2.56 | 3.03 | 2.84 | 2.39 | 2.25 | 2.17 | 2.57 | 2.67 | 4.06 |

*Since 2005 – only budget loans.

**presently, most of the transfers have been included in section 1.1.

Source: the Federal Treasury, the authors' calculations.

