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The review provides a detailed analysis of main trends in Russian economy in 2016. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and budget spheres; financial markets; 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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6.6. The new system of formation of the public Contract in 2016: the main risks and prospects of development¹

A switchover from financing of budget-funded entities on the basis of a financial estimate to financing of the services they rendered was underway for more than a decade, however, real changes took place only in 2016 when calculation of the volume of budget allocations to those entities on the basis of baseline expenditure normals became mandatory for all the entities of the budget system. The earlier approved amendments to Article 69.2 of the Budget Code of the Russian Federation (BC RF) specifying the general guidelines for developing the public contract (introduced by Federal Law No.83-FZ of May 8, 2010 and Federal Law No.406-FZ of December 29, 2015), as well as Resolution No.640 as amended of June 26, 2015 of the Government of the Russian Federation representing the third version of the procedure for formation and financing of the public contract in the past 10 years constituted the legal framework for the above changes. The main difference of the new procedure for formation of the public contract from the rules which were in effect before is a formal ban on customized standards being approved for individual entities which are under the jurisdiction of the chief administrator of the budget funds (CABF), that is, efforts were made to establish an unified system of standardized financing of public and municipal jobs and services. Among other things, the new system envisages the following *order of formation of specified allocations*:

- federal authorities in charge of development of a sectorial policy prepare base lists of public jobs and services (in compliance with Order No.49n of June 16, 2014 of the Ministry of Finance of the Russian Federation those lists are to be approved in respect of 32 lines of activities);

- the same authorities set baseline normals of expenditures for federal institutions and determine the types of adjustment sectorial ratios. Normals must be published on the official Internet-site which provides the information of public and municipal entities (bus.gov.ru). The content of the baseline normals has been expanded: it now includes the maximum scope of expenditures required for provision of public (municipal) services. If before 10% of costs on power and 50% of costs on heating were accounted for in the normals, from 2016 the above rates have been reduced with revenues from paid services taken into account. From 2019 it is planned to stop completely financing of the overall management of property which is not used for fulfilment of the public contract. In addition to the above, from 2016 the normal includes “costs related to purchasing of movable property” earlier financed through “other subsidies” which were calculated with the initially available property taken into account. From 2017, the normals will include “the amount of the reserve on complete rehabilitation of a particularly valuable movable property.” So, with a different extent of the initial availability of capital assets to entities and different wear rates of those assets, harmonization of funding normals sets inequality as regards the situation with entities’ property. As from 2019 providing of property to state and municipal entities in operating management is planned to be stopped and replaced by lease agreements or free use agreements with a simultaneous refusal to make budget allocations for payment of rentals on property which is not utilized in fulfillment of the public

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contract, the financial situation of such entities may deteriorate even further if idling of property happens to be justified by reduction of the volumes of the public contract;

- on the basis of the list of public jobs and services, founding authorities (CABF) at all the levels of the budget system develop departmental lists of public and municipal jobs and services on the basis of the baseline normals and adjustment ratios (at present there are territorial, sectorial and temporarily used adjustment ratios) and determine the volume of budget allocations to specific entities.

So, at first sight, the system of standardized financing limits the freedom of discretion of CABFs as regards issues of formation of public contracts and determination of the volume of allocations to specific institutions.

However, in practice a switchover to the principles of standardized financing is still largely formal, while the requirements of Article 69.2 of the Budget Code of the Russian Federation are not complied with in full. Also, it concerns the procedure for formation of the list of public services and formalization of the process of distribution of the public contract and the procedure for determination of the volumes of funding to specific institutions.

6.6.1. Baseline and departmental lists of public jobs and services

Identification of 32 lines of activities in respect of which base lists should be developed was not quite logically justified. They included both the lines in respect of which interdepartmental harmonization at all the levels of the budget system was actually required (education, healthcare and other) and those related to the exclusive competence of the federal level and carried out by a single agency (law, defense, foreign policy and other). Also, there is no strict functional division between base and departmental lists of public jobs and services: the types of the information provided in those lists and the extent of specification thereof overlap completely with most federal executive authorities (FEA). It is to be noted that a number of FEA are not specified in departmental lists available on open access even as regards functions which are not related to a secrecy order (the Ministry of the Interior and other). In 50% of cases, departmental lists come down to itemization of auxiliary types of federal executive authorities' activities, including health services, training of civil servants, health resort treatment and recreation and other. It can be explained by the fact that main functions of the whole range of FEA (primarily those related to national security and law-enforcement agencies) are carried out by public institutions financed on the basis of a financial estimate. Most FEA approached formally to development of base and departmental lists of public jobs and services without dividing explicitly services by their quality, methods of delivery, types of entities and levels of authority and specified all the types of the entities of the sector as providers of services. Due to the above, there is a situation where, for example, apart from profile entities a museum subordinate to the authority which is in charge of environment protection may be responsible for fulfilment of jobs related to shoreline protection. Classification of services on the basis of quality criteria in those cases where they were presented is carried out by most FEA by way of singling out a group of privileged institutions (leading higher education establishments, highly valuable cultural heritage sites and other) whose higher quality of services is presumed to be as such by virtue of a very special status of those institutions. There have been instances which permit to state that base and departmental lists are incomplete. It concerns all the cases where a departmental list includes types of activities carried out by one entity subordinate to FEA and

does not include those performed by other subordinate entities.¹ So, the requirements of Article 69.2 of the Budget Code as regards formation of the base and departmental lists of state services are complied with in most cases by FEA incompletely, while the system of standardized financing has consolidated the existing privileged position of entities with a special status and/or property which does not require any additional investments and maintenance-related costs, rather than ensured equality of entities providing services of comparable quality.

6.6.2. Formation of the public contract

Resolution No.640 of the Government of the Russian Federation proceeds from the fact that distribution of the public contract (hereinafter PC) between subordinated entities is to be carried out with some objective factors taken into account (dynamics of the number of consumers, level of satisfaction with the volume and quality of services, capacity of the entity, fulfilment of the contract in the previous year and other). However, the only FEA which tried at least partially to formalize the process of assignment of the public contract was the Ministry of Education and Science which approved the procedure for distribution of planned targets of enrollment into higher education establishments and secondary vocational training institutions. It is to be noted that the procedure for distribution of enrollment planned targets is not incorporated into the procedure for public contract formation and is carried out in accordance with other rules.

Other FEA distribute the public contract proceeding mainly from the practice which existed before and that turns the process of public contract distribution into a major instrument of customization of budget funding.

With the above taken into account, the issue is topical whether further formalization of public contract distribution is expedient and possible. It appears that it would create more risks than advantages. The main factor consists in the fact that it is difficult to form the system of criteria on which basis it would be possible to formalize the public contract distribution process: in most cases the indicators of quality (efficiency) of entities are formal and based on the parameters of activities which are more available for external evaluation and do not normally characterize the very process of service supply. For example, it is easier to compare the initial value of museum collections than the quality of jobs related to maintenance and restoration thereof. Also, it is easy to compare average grades as regards the single state exam (SSE) for students entering higher education establishments of the same profile than the quality of lectures delivered at those institutions. The extent of public contract administration in the previous periods depended on the entire range of external factors for entities, including a feasibility of cuts in budget funding during the previous year; in most cases the number of consumers of services changes very slowly and insignificantly, so it cannot be used as a basis. The mechanisms of accounting of the extent of consumer “satisfaction with the existing volume and quality of services and the outputs of work” of entities on the federal level are not developed enough. In a number of sectors, they are partially realized by way of granting to consumers the right to select a budget-funded entity. For example, in healthcare a consumer may get registered with an out-patient hospital which he/she believes provides higher quality services.² However,

¹ So, for example, the base list of the Roskosmos includes one service: “organization and carrying out of selection of applicants for the position of a space crewman...”, while the departmental list includes only 4 services. Such an approach would have been justified if within jurisdiction of FEA there were no entities carrying out other types of services, but it is not so.

² See, for example, Article 36.10 of Federal Law No.326-FZ of November 29, 2010 on Mandatory Medical Insurance in the Russian Federation; Order No.543n of May 15, 2012 of the Ministry of Health and Social

the mechanism based on a consumer choice financing has limitations of its own. Firstly, it is effective only in large cities with a developed budget-funded network and good transport accessibility, that is, in a situation where consumers have actually got a choice. Secondly, utilization of the above mechanism is partially limited by capacity of budget-funded entities selected by individuals: though in some instance it may be exceeded¹, certain limitations do exist, anyway. Thirdly, there are virtually no mechanisms which would permit to build formalized correlation between claims of budget service consumers and the volumes of funding to an entity (in particular, claims need to be divided into justified and unjustified ones).

So, it is quite difficult to formulate objective criteria for formalized distribution of the public contract between entities. It is to be noted that a switchover to a tender-based distribution of the public contract creates risks of incomplete utilization of entities and, as a consequence, incomplete funding which situation would mean gradual asset portfolio degradation and a loss of HR potential for entities receiving less volumes of the public contract than before.

The instance of a tender-based distribution of enrollment target figures in higher education is not exhibitive: as in the past few years it was subjected to optimization process it is rather complicated to assess the effect of an individual factor on the situation of higher education establishments. According to the data of the Ministry of Education and Science², in the 2012–2015 period 46 higher education establishments and 19 branches were restructured, 269 branches were closed down and 43 branches were restructured for fulfilment a different function. In 2015, restructuring was underway with other 27 higher education establishments and 334 branches. In the 2014–2015 period, plans were announced to cut “... up to 80% of branches of higher education establishments ... [and] ...40% of higher education establishments... provided that the number of students receiving high quality higher education ...with federal and national research universities increases”. In particular, similar plans could be found in Instructions No. 2765-r of December 29, 2014 of the Government of the Russian Federation on the Concept of the Federal Target Program of Development of Education in the 2016-2020 Period. Though Resolution No.497 of May 23, 2015 of the Government of the Russian Federation taken on the basis of the above Concept does not include straightforward instructions as regards the extent of the planned optimization, the process of optimization of entities is not completed yet.

6.6.3. Implementation of the standardized financing principles

Despite the requirements of Article 69.2 of the Budget Code of the Russian Federation, the values of baseline normals and sectorial adjustment ratios were published only by 5 CABF (the Ministry of Education and Science, the Ministry of Sport, the Administrative Department of the President of the Russian Federation, the Ministry of Healthcare and the Ministry of Culture (not in respect of all the types of services)) due to which the analysis of the practice of standardized

Development of the Russian Federation on Approval of the Guidelines for Provision of Primary Health Care to Adult Population; Letter No. 2056/26-i of May 8, 2009 of the Federal Mandatory Medical Insurance Fund on Guidelines for Methods of Payment of Medical Services in Phased Transition to Single Channel Financing and other documents.

¹ See, for example, Appellate Ruling No.33-4118/2013 of May 28, 2013 of the Altai Territory Court by which the court obligated an outpatient hospital to register a patient despite the fact that recommended load on general practitioners was exceeded by large.

² The Report – The Priorities in Development of the System of Higher Education in the Russian Federation – by S.O. Sorokin, Deputy Director of the Department of the State Policy in Higher Education of the Ministry of Education and Science // URL: <http://минобрнауки.рф/>

financing was carried out both on the basis of open source data and outputs of surveys in which 137 budget-funded entities participated.

Resolution No.640 of the Government of the Russian Federation provides for determination of standard costs of federal entities with application of the following three methods: a normative method, a more efficient entity method and a median method. Other methods are admissible for regions, too. They include primarily the following three methods which were earlier applied by federal agencies: the expert method, structural method and a countdown method (which is not advised at present by the Ministry of Finance of the Russian Federation). It was believed that the normative method based on normals of material, technical and labor resources (construction norms and rules (SNiP), sanitary regulations and standards (SanPiN), standards, procedures and rules of service provision and fulfilment of jobs (items 18 and 31 of the Resolution No.640 of the Government of the Russian Federation)) envisaged by federal statutory acts would permit to ensure funding of services rendered by the budget-funded sector in the volume required for ensuring quality in compliance with relevant standards and constitute a base for a unified approach to determination of their costs by each sector. However, in practice the correlation between the volume of budget allocations to sectorial entities and real normals which determine the quality of services is notional. Entities' standard costs are calculated on the basis of the "available" volume, that is, the volume of allocations made by CABF, while real normal (GOSTs, SanPins and other) play an auxiliary role and are used at the most for proportional allotment by CABF of allocations between subordinate entities. In addition to the above, the normative method of calculation of the volume of budget allocations to entities is de facto unacceptable amid unstable budget revenues. In a situation where CABF have to adjust (generally reduce) thresholds of budget allocations during a year, correlation of budget funding with real normals is completely lost.

According to the data of our research, the normals of financing of budget services differ from market prices on similar services and amount to 10% to 100% of their market value. So, the situation of budget-funded entities placed in quasi-competitive conditions is highly risky: on one side they are exposed to a risk of underperformance and underfunding, while on the other side their freedom in taking management decisions remains limited (in particular, they cannot refuse from a portion of the public contract in favor of rendering services to households at market prices), whereas allocations they receive cannot make up for all the costs required for provision of services in compliance with the standard and/or on comparative market conditions.

At the same time, CABF have preserved plenty of options of customization of funding of subordinate entities. For those purposes, they use the following: financing of jobs, application of sectorial and adjustment ratios, allocation of subsidies for other purposes and customized distribution of the deficit of budget allocations.

Until 2017, a number of CABF used jobs as an instrument of evasion of the requirements of Article 69.2 of the Budget Code of the Russian Federation as financing of jobs was not standardized until recently. For example, in the base list of public services (jobs) approved by the Ministry of Culture of the Russian Federation¹, one and the same type of activities can be classified both as a job and service which situation permitted agencies to bypass tough requirements set to standardization of services with an explicit creative customized nature and finance complementary entities which received less funding by standards set for services. For example, such a type of activities as "public showing of museum pieces and museum

¹ URL: <http://www.bus.gov.ru/pub/services>

collections” can be financed both as a job and service.¹ Sampling analysis of plans of financial and business activities of entities which were within the jurisdiction of the Ministry of Culture of the Russian Federation showed that there were museums and theaters whose public contract was made up completely of jobs; for a number of large and most important entities of culture, jobs account minimum for 50% of the public contract.

Sectorial adjustment ratios are used as an instrument of customization of budget allocations by the following two methods:

- a few ratios aimed at increasing the volumes of allocations to a privileged group of entities are introduced. For example, by Order No.1272 of October 30, 2015 of the Ministry of Education and Science of the Russian Federation multiplying ratios for the (leading) higher education establishments which were granted the right to approve standards of their own, as well as multiplying ratios for the very fact of application of those standards and a number of other ratios permitting to increase volumes of allocations to that particular category of budget recipients were envisaged. As a result, leading higher education establishments accounted for over 40% of allocations allotted for financing higher education as a whole²;

- non-transparent content ratios are applied. For example, by Order No.1038 of December 31, 2015 of the Ministry of Health of the Russian Federation an adjustment ratio “reflecting the specifics of implementation of educational programs” of medical higher education establishments ensuring a differentiation of volumes of financing of services by 400% was approved. The value of the above ratio was set individually for each of 56 medical educational establishments.³ It is to be noted that in departmental documents of the Ministry of Healthcare it is not specified what should make an educational program of a medical higher education establishment special so that it could claim a higher volume of funding. It is to be noted that funding of educational establishments which are within the jurisdiction of the Ministry of Culture of the Russian Federation is carried out in a similar way.

Adjustment (multiplying and reduction) ratios can be applied to each entity individually and until recently they used to be the main instrument of customization of budget-funded entities’ standard costs. It is to be noted that adjustment ratios can be applied only temporarily within a transition period. With the above taken into account, a question arises how the practice of distribution of budget allocations between entities after customized adjustment is abandoned is going to change. Analysis of agencies’ documents and outputs of our survey of budget-funded entities have shown that refusal from utilization thereof would sooner be inexpedient.⁴

The thing is that in practice multiplying ratios are used more rarely than reduction ratios which are applied on a large scale. It means that the main factor behind application of adjustment ratios is a shortage of budget funds for funding services in compliance with normals, rather than CABF’s intention to preserve the earlier formed volume of funding of the budget institution network. For example, in the 2016-2018 period in the Republic of Komi the reduction adjustment ratio is applied to all the social in-patient departments.⁵ In the course of

¹ URL: <http://www.bus.gov.ru/pub/services>

² URL: <http://regconf.hse.ru/uploads/3e50fea0e58869eb82b707696c7fc89e1497d069.docx>

³ URL: <https://www.rosminzdrav.ru/ministry/informatsiya-o-podvedomstvennyh-ministerstvu-zdravoohraneniya-rossii-organizatsiyah>

⁴ See, for example: A.G. Lovidova. Challenges in the Field of Upgrading of Efficiency of Public Services in 2016 // Manager of Autonomous Entity. 2016. Issue No.6. pp. 19–23.

⁵ Order No.2280 of September 30, 2016 of The Ministry of Labor, Employment and Social Protection of the Republic of Komi on Approval of Values of Baseline Standard Costs on Provision of Public Services (Jobs) and

our survey, representatives of some leading federal higher education establishments spoke about a 25%-30% customized reduction of funding volumes as compared to those calculated on the basis of the normals. So, in case of abandonment of the practice of customized adjustment it would be impossible to finance all the services in compliance with the existing normals. As a consequence, it would be necessary either to reduce the values of baseline normals applicable to all the entities, thus making worse the situation of “ordinary” participants -- that cannot take advantage of sectorial ratios -- in the budget institution network, or reduce the total number of services rendered to households.

As regards distribution of the deficit between budget-funded institutions, that issue failed to be duly regulated, while all the surveyed entities answering the question about the practice of reducing budget allocations in substance said that it was carried out on an individual basis.

Distribution of subsidies allocated to entities “for other purposes” is customized, too. Despite the fact that most CABFs have approved documents specifying the lines of allocation of subsidies for other purposes (building, overhaul, procurement of expensive equipment and other), the procedure for distribution of subsidies between entities is not set, while decisions on allocation of subsidies are taken by CABFs at their own discretion.

The practice of customization of budget financing is widely used at the sub-federal level, too. Though from 2016 public-law entities of the sub-federal level are obligated to switch over to standard principles of funding of public services, it did not happen overall. On the one side, introduction of standard principles of funding creates potential risks of limitation of budget independence of regions and local governments: confidential nature of base lists of public services limits regions’ and local governments’ independence in identification of lines of spending of funds. In addition to the above, the normative method of calculation of costs suggests that numerous federal standards, sanitary norms and rules, as well as guidelines approved by federal executive authorities which are in charge of management of various sectors should be taken into account and as a result of that the minimum amount of costs is formed for services to be rendered. On the other hand, the above risk is mitigated by the fact that the volume of subsidies allocated to entities of the sub-federal level is normally calculated on the basis of the available one. The analysis of the regional base has shown that there is a lack of harmonization of the values and pattern of regional baseline normals of costs even on such types of activities – which are overregulated by standards -- as services of pre-school education establishments; also it was established that the practice of utilization of customized adjustment ratios was widespread and there were instances of regions’ evading a switchover to standards. So, representatives of most regional museums and theaters which took part in the survey said that funding they received was of a customized nature.

According to the data of our survey, no radical changes took place in the funding volumes of most entities partially due to the fact that values of some baseline normals of costs were determined at previous stages of the reforms by means of a countdown method and in addition to that federal executive authorities actively applied sectorial and adjustment ratios. So, having failed to solve the initial issue of upgrading transparency and formalizing distribution of budget allocations, a switchover to standardized financing have created additional risks for the budget institution network’s functioning, in particular:

- there is a risk of incomplete provision of entities with the public contract, which situation entails gradual degradation of the budget institution network despite the fact that federal

executive authorities have necessary instruments at their disposal to optimize it (restructuring, liquidation, change of an entity's management), while private providers cannot guarantee stable provision of services to households;

- the standardized system of funding complicates support and development of vulnerable, but necessary entities which for one reason or another cannot be liquidated;

- gradual switchover of a portion of the market of public services to non-government suppliers and the ideas of establishing a competitive (or quasi-competitive) environment are underpinned by provision of greater managerial independence to entities, that is, risks of entities grow disproportionately high to their potential;

- standardization of expenditures on maintenance of property and refusal to maintain from 2019 the state property which is not used in rendering of services will entail in the long-term prospect degradation of property units which are in ownership of public-law entities;

- Methods used in calculating baseline normals of costs contribute to deterioration of the quality of services, rather than upgrading thereof: as quality indicators are generally formal, "the more effective entities are those which make less investments to ensure rendering of services (that is, those which increase load on reduced personnel, cut investments in software and expenditures on expendables, liquidate services, which are not accounted for in the list of quality indicators, to households and other).