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Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:

Yushkov, A. (2020). Regional Public Finance in Russia in 2012-2019. *Russian Analytical Digest*, 262, 17-22. <https://doi.org/10.3929/ethz-b-000458207>

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ANALYSIS

Regional Public Finance in Russia in 2012–2019

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DOI: 10.3929/ethz-b-000458207

Abstract

Regional public finance in Russia has undergone some important transformations since 2012. Although the structure of revenues remained relatively stable between 2012 and 2019, the structure of expenditures changed, due in part to new unfunded mandates in education and healthcare, as well as to the increased use of extrabudgetary funds. Moreover, the federal government revised its transfer policy to make it less generous, forcing several regions to significantly increase their public debt or reduce social spending. The transparency of the intergovernmental fiscal system also declined during this period as budget credits and politically motivated federal transfers (including new forms of discretionary unconditional grants and “other transfers”) became widespread.

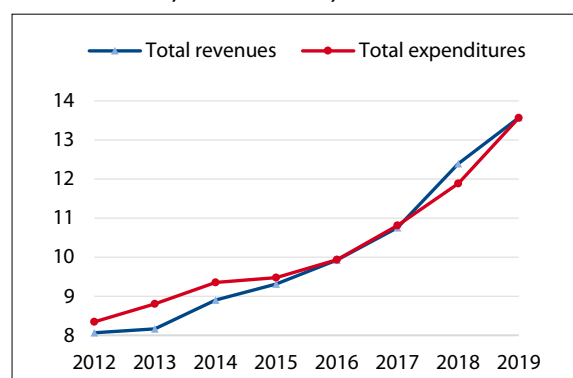
Major Public Finance Trends in Russian Regions (2012–2019)

Regional expenditure priorities, federal transfer policies, and subnational debt management in Russia have changed considerably since the start of Putin's third term in 2012. However, the composition of regional revenues (excluding transfers) has been relatively stable over this period. This analysis will summarize major trends in regional government revenues, expenditures, and debt, as well as intergovernmental fiscal transfers that regions receive from the federal government. Additionally, I will briefly discuss the state of public finance in regions that elected their governors in 2020.

Figure 1 shows the evolution of nominal revenues and expenditures of consolidated regional budgets since 2012. A consolidated regional budget in Russia is calculated as the sum of the regional budget and corresponding local budgets, including the budgets of cities, city districts, municipal raions, and urban and rural settlements. One clear tendency is that regional expenditures usually increase after presidential elections. They grew steadily in 2012–2014 and 2018–2019. The crisis of 2014–2015, meanwhile, prevented regional governments from keeping up this pace. In fact, the real expenditure of consolidated regional budgets (adjusted for inflation) declined in both crisis years.

Another noticeable trend is that regional governments, on average, experienced budget deficits in 2012–2015. This implies that at least some of the obligations imposed on regions by the Presidential Decrees of 2012 (known as the May Decrees) represented unfunded mandates. Even after receiving federal transfers intended to cover increased expenditures, some regions had to use deficit financing and issue various debt instruments to bridge the gap between their revenue capacity and their expenditure needs. After 2015, consolidated regional budgets were mostly balanced or ran a small surplus. This paradox can be partly explained by the fact that the richest regions, including Moscow, St. Petersburg, and the oil-extracting regions, were in surplus during this period. Federal transfers also began to play a more important role after 2017.

Figure 1: Revenues and Expenditures of Consolidated Regional Budgets, 2012–2019 (Nominal, Trillion Rubles)



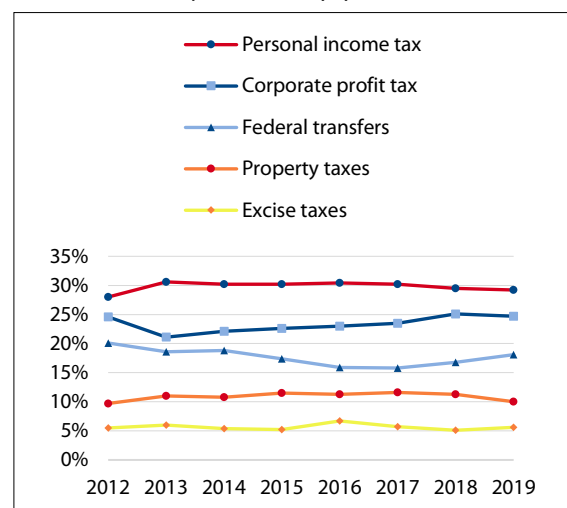
Source: Russian Federal Treasury

Revenues

Since the early 2000s, two major sources of consolidated regional government revenues have been personal income tax and corporate profit tax. Although these taxes are considered federal under the Budget Code of Russia, the funds collected are almost entirely given to regional and local budgets (just 15% of profit tax revenue, for instance, remains in the federal budget). Together, they account for more than half of all consolidated regional revenues. Federal fiscal transfers constitute the third-largest revenue source, fluctuating between 15% and 20%. Property taxes remain much less important for regional and local budgets in Russia than in most other federations. In total, corporate and personal property taxes as well as the land tax account for slightly more than 10% of consolidated regional revenues, while excise taxes, mostly on gasoline and alcoholic beverages (except spirits), comprise a further 5% of regional and local revenues. Taken together, these five revenue sources account for about 85–90% of consolidated regional revenues. Other types of revenue that are important for some

regions include the mineral extraction tax (even though its oil and gas portion was almost entirely centralized in the mid-2000s) as well as various fees and charges. Figure 1 shows the composition of consolidated regional government revenues in 2012–2019, including the revenues of both regions and municipalities.

Figure 2: Structure of Regional Government Revenues, 2012–2019 (%)



Source: Russian Federal Treasury

Even though the structure of regional and local revenues was relatively stable throughout the period under study, two notable trends deserve attention. First, the corporate profit tax was a more volatile source of revenue than the personal income tax. In 2013, the corporate profit tax dropped from 25% of consolidated regional government revenues to around 20%; it remained at that level through the crisis years of 2014–2015, rising back to 25% only in 2018. This marked a significant decline from the mid-2000s, when the corporate profit tax comprised more than 30% of consolidated regional government revenues, reflecting the overall slowdown of the Russian economy in the 2010s.

Second, federal transfers have declined as a share of consolidated regional revenues. Somewhat surprisingly, the most substantial shock to federal transfers came between 2014 and 2016, when the economy was in stagnation. Alexeev and Chernyavskiy (2018) show that the federal government was much less generous during the crisis of 2014–2015 than it had been in 2009, when Russia faced the aftershocks of the Great Recession. Poorer regions were disproportionately impacted by the absence of federal financial support in the mid-2010s. Another explanation for the decline in transfers is that Moscow changed its intergovernmental fiscal strategy, starting to use alternative—and usually less transparent—mechanisms of regional financing, including federal budget credits (see the *Debt* section below).

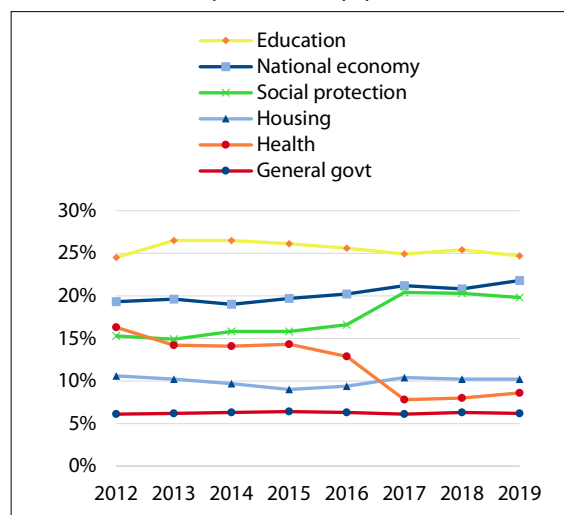
Expenditures

Regional expenditures, particularly those related to human capital, were expected to change considerably after 2012, when Putin signed the May Decrees. These decrees obliged regions, among other things, to increase the wages of teachers, doctors, and other public-sector employees. However, as depicted in Figure 3, although spending on education and healthcare initially increased as a share of the total (healthcare spending rose in 2012 and education spending in both 2012 and 2013), this spending soon stabilized at 26% and 14%, respectively, of total expenditures. Healthcare spending later dropped sharply, falling to less than 8% of total spending in 2017. The reason for this dramatic change was that healthcare came to be financed largely through extrabudgetary funds (particularly the Federal Compulsory Medical Insurance Fund): as of 2017, 1.9 trillion of the 2.9 trillion rubles of regional medical spending came from extrabudgetary funds. This gave the federal government, which de facto managed extrabudgetary funds, more control and discretion over the healthcare sector. At the same time, regional social protection spending increased from 17% to 20% of total expenditures (from 2.2 to 2.4 trillion rubles). One plausible explanation is the political cycle: 2017 was the year before the presidential election of 2018 and regional governments were mobilized as agents of the federal government, charged with allocating much-needed financial support to the people. Other expenditure areas remained relatively stable in 2012–2019. Spending on the national economy (mostly roads and highways) and housing (mostly communal utilities) hovered around 20% and 10%, respectively, of the total.

Transfers

Federal transfers were the least stable source of revenue for consolidated regional budgets in 2012–2019. While their total amount did not fluctuate much, the composition of transfers changed drastically, as Figure 4 shows. Since the early 2000s, the federal government has used both unconditional and conditional fiscal transfers to support regions and implement federal policies at the sub-national level.¹ Initially, unconditional transfers (*dotatsii*) were designed as formula-based grants aimed at equalizing fiscal capacity across regions without imposing any limits on their spending. Over time, however, the federal government divided unconditional transfers into formula-based equalization transfers (*dotatsii na vyравnivanie biudzhetoj obespechennosti*) and discretionary balancing transfers (*dotatsii na obespechenie sbalansirovanosti biudzhetov*) that were allocated monthly or quarterly

Figure 3: Structure of Regional Government Expenditures, 2012–2019 (%)



Source: Russian Federal Treasury

according to federal government decrees. Obviously, the second type was much less transparent and more politically motivated. These transfers were used extensively during the crisis of 2009 and peaked at 19% of all federal transfers in 2014. Later, however, their share declined sharply, falling to only 2% of total federal transfers in 2019. The reason for this was not the increased utilization of formula-based equalization transfers (although these increased from 24% of the total in 2012 to 36% in 2017) but the creation of several new types of unconditional transfers in 2017. Some of these new transfers—which comprised more than 8% of total federal transfers by 2019—were region-specific and inherently political (e.g., special transfers to Chechnya and Crimea), while others were conditional in nature (e.g., transfers aimed at increasing the salaries of public sector employees) and thus undermined the very concept of unconditional equalization. Overall, the share of unconditional transfers increased from 32% of the total in 2012 to 49% in 2018 before falling to 38% a year later. Predictability and transparency, the two most important principles of an intergovernmental fiscal system in a federal country, were clearly violated in Russia in the mid-2010s.

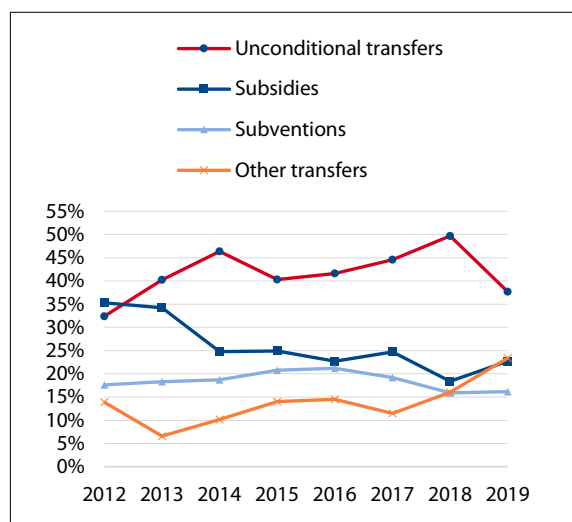
The most common type of conditional transfers are subsidies used to co-finance regional capital expenditures by providing matching federal funds. These tend to gradually decrease over time. After experiencing positive shocks in the years following presidential elections (particularly in 2012–2013), they stabilized at around 22–23% of total federal transfers.

¹ According to the normative fiscal federalism theory, unconditional grants should be based on an equalization formula and provided to those regions “with the greatest fiscal need and the least fiscal capacity” (Oates 1999), while conditional grants should be provided in the form of matching grants to internalize spatial externalities.

Another alarming tendency that can potentially be linked to political influence is the rapid increase of the share of “other transfers.” This type of transfers was almost negligible before the 2010s but then absorbed some former subsidies and subventions (which are used to finance federal responsibilities that are “transferred” to regions) and continued growing during the 2010s, peaking at more than 23% of all transfers in 2019. Other transfers are less transparent than subsidies and subventions since they 1) are allocated annually and are thus much less predictable; 2) are used to finance short-term projects, often involving funds from the Presidential Reserve Fund, instead of long-term government programs; 3) are discretionary in nature and can be used to achieve political goals; and 4) undermine regional fiscal autonomy since, unlike subsidies, they do not require co-financing.

Overall, the composition of federal transfers became even less transparent and more susceptible to political manipulation in the period between 2012 and 2019, which is just another step toward fiscal centralization and the reduction of regional and local autonomy.

Figure 4: Structure of Federal Transfers to Regions, 2012–2019 (%)



Source: Russian Federal Treasury

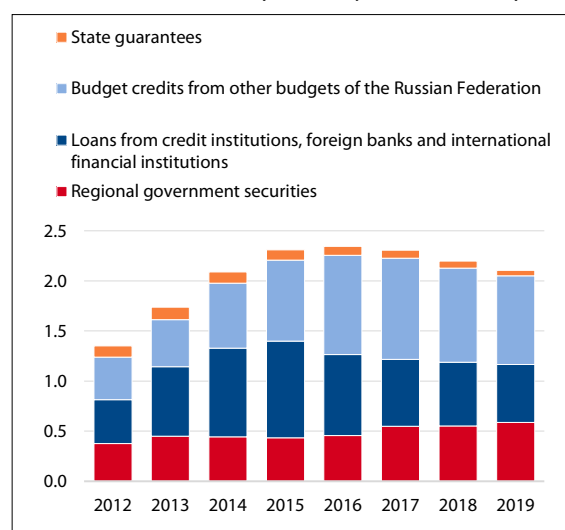
Debt

As federal transfers declined in 2012–2016, Russian regions began issuing more debt to cover their growing expenditure needs and new unfunded mandates in education and healthcare. Over this five-year period, total regional debt increased from less than 1.5 trillion to more than 2.3 trillion rubles. Johnson and Yushkov (2020) show that regional debt, and particularly budget credits, during this period became a substitute for declining federal transfers. The composition of debt

also changed considerably (see Figure 5). The Ministry of Finance became more aggressive in providing cheap budget credit to regions: as a result, the total volume of such credits more than doubled in nominal terms, from 0.4 trillion to almost 1 trillion rubles, between 2012 and 2016. Compared to market debt instruments (e.g., government securities and commercial loans), budget credits have an exceptionally low interest rate (0.1%), with the result that when regions pay back the credit, they pay much less in real terms than they originally borrowed.

Commercial loans grew at almost the same rate as budget credits, as regions that were unable to attract federal financial support in the form of transfers or budget credits had to find other, usually much more expensive, sources of financing to cover unfunded federal mandates and move toward achieving the goals of the May Decrees. The interest rate of commercial loans was well above 10%, especially during the crisis of 2014–2015. Recent changes in the Budget Code further incentivized regions to reduce their debt burden by limiting regions’ access to transfers and other forms of federal support if they spend more than 10% of their total expenditure on debt service. This policy, however, can create a vicious circle, since highly indebted regions will lose access to some federal funding and will have to borrow even more to repay their current debts, potentially leading to a series of regional bankruptcies in the future.

Figure 5: Subnational Debt in Russia by Category, 2008–2016 (Nominal, Trillion Rubles)



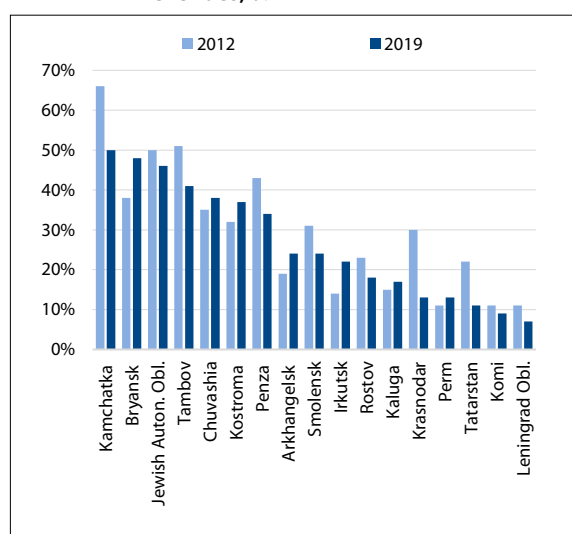
Source: Russian Ministry of Finance

Public Finance in Regions with Gubernatorial Elections in 2020

Those gubernatorial elections held in 2020 were much less competitive than local elections in large cities (in particular, Tomsk and Novosibirsk) or even than certain

gubernatorial elections in previous years. All the incumbents and federal appointees managed to get themselves (re)elected, although the results were not totally uniform. One obvious reason for this is massive electoral fraud and data manipulation. Another, somewhat more sophisticated explanation is that the federal government deliberately targeted these regions over the last few years to ensure the (re)election of Kremlin-supported candidates.

Figure 6: Federal Transfers as a Share of Regional Revenues, %



Source: Russian Federal Treasury

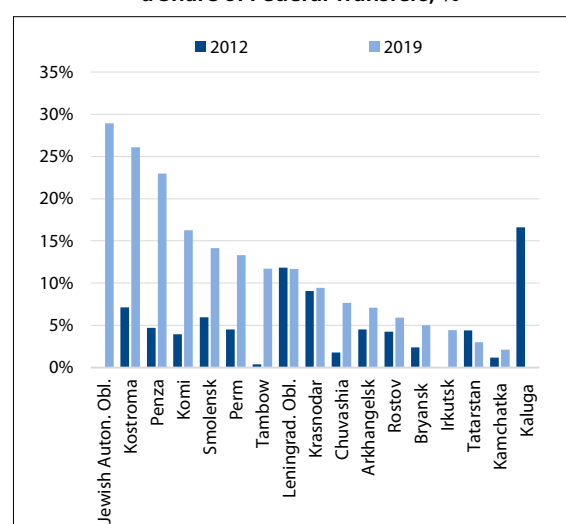
Figure 6 shows the dependence on federal transfers (in 2012 and 2019) of regions where gubernatorial elections were held in 2020. It seems that no overarching transfer policy specifically targeted these regions. Some regions actually improved their fiscal condition and reduced their dependence on transfers, primarily due to growth in the corporate profit tax (Leningrad Oblast, Komi, Tatarstan, Krasnodar Krai). Some other regions became slightly more dependent on federal financial support (Bryansk, Kostroma, and Arkhangelsk Oblasts, Chuvashia), a development that was apparently unrelated to political business cycles. Only one region seems to have been targeted by the federal government: Irkutsk Oblast, which has traditionally been one of the most protest-prone regions. The communist governor was recently replaced by a Kremlin-backed candidate, who presumably needed additional funding for his campaign. The share of transfers in this region was relatively low over the last several years but increased considerably—to 22%—in 2019.

About the Author

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However, if we look more closely at the share of discretionary (not formula-based) unconditional transfers to these regions, a different picture emerges (see Figure 7). Discretionary unconditional transfers increased dramatically between 2012 and 2019. In part, this reflected the general trend discussed above. That being said, some regions seem to have been particular targets of these non-transparent forms of federal support. Interestingly, regions that received more of these transfers—which were not aimed at fiscal capacity equalization or co-financing of government programs, and thus could have more easily been used to finance the incumbent's campaign—demonstrated significantly higher levels of support for the incumbent in the 2020 elections. With the exception of Smolensk Oblast, where the incumbent did not represent the ruling party, all regions with a share of discretionary unconditional transfers above 10% demonstrated more than 70% support for the incumbent. As such, either the federal government achieved its (re)election goals by using less transparent fiscal transfers that were used to finance the incumbents' campaigns or else the regions that received more discretionary transfers used electoral fraud and data manipulation more frequently. Whatever the case may be, such discretionary financial flows from the federal center to regions serve as an important political mechanism of quasi-competitive electoral politics at the regional level.

Figure 7: Discretionary Unconditional Transfers as a Share of Federal Transfers, %



Quelle: Föderales Schatzamt Russlands

World Bank technical assistance projects related to public financial management and program evaluation in Russian regions and municipalities.

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