

# PUBLIC FINANCE

DOI: 10.15838/esc/2015.1.37.10  
UDC 336.14(470.12), LBC 65.261.713(2Rus-4Vol)  
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## Regional budget for 2015–2017: doing away with deficit or doing away with development?



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**Abstract.** Regional budget in the Vologda Oblast for 2015–2017 was formed under difficult socio-economic conditions caused not only by a longstanding dependence of Russia's economy and its budget system on the external economic environment, but also by a number of new factors associated with the aggravation of geopolitical tensions and the application of sectoral sanctions by Western countries.

Despite an uncertainty in economic development trends, the new budget is announced to be deficit-free. It would seem that the balance of revenues and expenditures, a fundamental principle of the budget system, has been achieved. However, an analysis of the expenditure part of the budget shows that the balance is achieved at the expense of introducing the austerity regime followed by the restriction of all directions of funding. For 2015–2017 the share of the regional budget expenditures in GRP will decrease to 9.8% vs. 13.6% in 2014. If macroeconomic dynamics maintains its downward trend, such fiscal policy in the long term will suppress the economy even more significantly and will ultimately lead to the taxable capacity reduction.

Under the conditions of economic activity slowdown, even if the budget is balanced, it will not be possible to neutralize the cyclical risks connected with the receipt of profit tax from the metallurgical and chemical industries that are integrated into the world economy and act as the major budget revenue generating industries in the region. Simple calculations prove that at the current high level of debt load it will be extremely difficult for the government to overcome the dependence on borrowed funds; therefore, it seems rather doubtful that the budget balance over the forecast period can be achieved.

The author analyzes several laws on the regional budget<sup>1</sup> and comes to a conclusion that the fiscal policy pursued by the federal government is flawed because it focuses on fiscal functions rather than on stimulating and regulating functions that promote economic growth.

The growing problems at the regional level will sooner or later require that the center make definite decisions. The article substantiates practical recommendations for stabilizing the regional and local budget systems; this stabilization should be accompanied by the adoption of measures to adjust fiscal policy.

**Key words:** regional budget, deficit, loans, debt load, fiscal policy adjustment.

The global economy, as well as Russia's economy, will retain its low growth rate in the coming years. At that, Russia's economy will be growing significantly lower compared to the global economy. The uncertainty of macroeconomic trends may increase due to the forecasted decrease in oil price<sup>2</sup>, which is the key parameter in the formation of budget revenues (*fig. 1*).

A forecast of economic and social development of the Vologda Oblast for 2015–2017 [9], reflecting national trends, is characterized by the stagnation of all macroeconomic indicators against the background of a dramatic decline in investment activity (*tab. 1*).

GRP growth in 2015–2017 is expected to be achieved by boosting industrial production and consumer demand. However, in our opinion, there are risks of failure to achieve the forecast GRP values, which are not connected with the negative

dynamics of investments in fixed capital. It is expected that in 2017 capital investment will be reduced by 23.2% compared to the level of 2014; this fact predetermines a slowdown in GRP growth.

No doubt, economic problems cannot but affect the state of the budget system in the region; although, at first glance, the main parameters of a new three-year budget [8] seem to be very optimistic.

It is forecast that both aggregate and own revenues will grow. But the absolute indicators themselves show little. A system error of budget planning at the regional level consists in the lack of correlation between the main parameters of the budget and GRP.

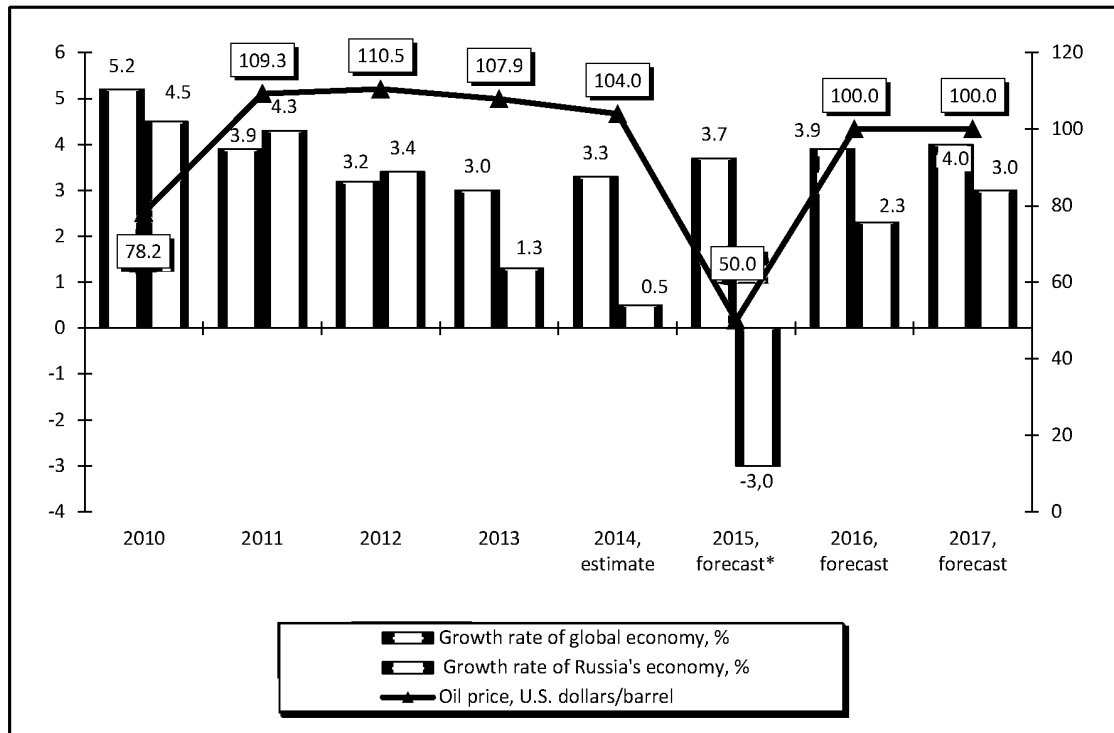
According to our estimates, the share of regional budget revenues in GRP will decline to 10.7% in 2017 vs. 12.5% in 2014, which indicates the long-term deficit of financial resources (*tab. 2*).

<sup>1</sup> Povarova A.I. Formirovanie regional'nogo byudzheta v usloviyakh krizisa [Formation of Regional Budget in Crisis]. *Ekonomicheskie i sotsial'nye peremeny: fakty, tendentsii, prognoz* [Economic and Social Changes: Facts, Trends, Forecast], 2010, no. 2, pp. 101–114; Povarova A.I. Trekhletnii byudzhet: zhdet' li stabil'nosti? [The Three-Year Budget: Should We Wait for Stability?]. *Ibidem*, 2011, no. 2, pp. 20–36; Povarova A.I. Regional'nyi byudzhet 2012–2014: stabil'nost' otkladyvaetsya [Regional Budget of 2012–2014: Stability is Delayed]. *Ibidem*, 2012, no. 3, pp. 39–58; Povarova A.I. Regional'nyi byudzhet 2013–2015: stabil'nost' ili vyzhivanie? [Regional Budget for 2013–2015: Stability or Survival?]. *Ibidem*, 2013, no. 1, pp. 36–55.

<sup>2</sup> In January 2015 the average world price of Urals crude oil amounted to 45 U.S. dollars per barrel, which is 2.2 times lower than the rates laid down in the federal budget for 2015. According to the information available at the RF Government website, Russia's Prime Minister D. A. Medvedev instructed the Ministry of Economic Development to prepare a new forecast of the country's socio-economic development for 2015.

The scenario forecast for 2015 developed at the Institute of Economic Forecasting of the Russian Academy of Sciences provides for the decrease of GRP by 4% in the stress option, by 2.5% – in the conservative option, and by 0.3% – in the optimistic option.

Figure 1. Global and Russian economic growth rates, oil price in 2010–2017



\* The 2015 data include the new forecast introduced to the Government by the Ministry of Economic Development.

Source: Ministry of Economic Development [11].

Table 1. Main macroeconomic indicators for making the draft regional budget of the Vologda Oblast for 2015–2017, in comparable prices, % to the previous year

Indicators	Fact				2014, estimate	Forecast			2017 to 2014, %
	2010	2011	2012	2013		2015	2016	2017	
GRP	105.7	106.9	104.8	100.0	100.5	102.7	102.0	101.3	106.1
Industrial production index	111.1	105.6	101.3	102.3	101.3	102.6	101.7	102.7	107.2
Investments in fixed capital	116.1	149.4	121.2	46.2	77.7	118.0	94.7	68.7	76.8
Retail trade turnover	116.3	107.6	119.7	101.7	100.5	100.4	102.8	103.2	106.5
Real disposable money incomes of the population	109.3	100.1	106.9	105.4	100.0	102.1	102.5	103.0	107.8

Table 2. Main parameters of regional budget in the Vologda Oblast, billion rubles

Parameters	Fact						Forecast			
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenues, total	39.5	31.2	36.1	39.3	42.4	40.3	45.1	43.0	45.9	47.3
As a percentage of GRP	13.4	14.6	13.7	12.2	11.9	11.3	12.5	10.8	10.8	10.7
Tax and non-tax (own) revenues	34.4	19.0	25.8	28.8	31.5	30.3	34.9	35.9	40.6	41.9
Expenditures	39.1	37.7	43.1	46.5	45.2	44.2	49.0	43.0	38.0	43.5

A year ago the forecast for the 2014–2016 provided for GRP amounting to 402.9 billion rubles in 2015 and 437 billion rubles in 2016, the forecast for 2015–2017 reduced the amount of GRP reduced to 5.7 billion rubles in 2015 and to 13.7 billion rubles in 2016. Thus, in 2015–2016, if the planned level of regional budget revenues is 10.8% of GRP, then over 2 billion rubles will not be received.

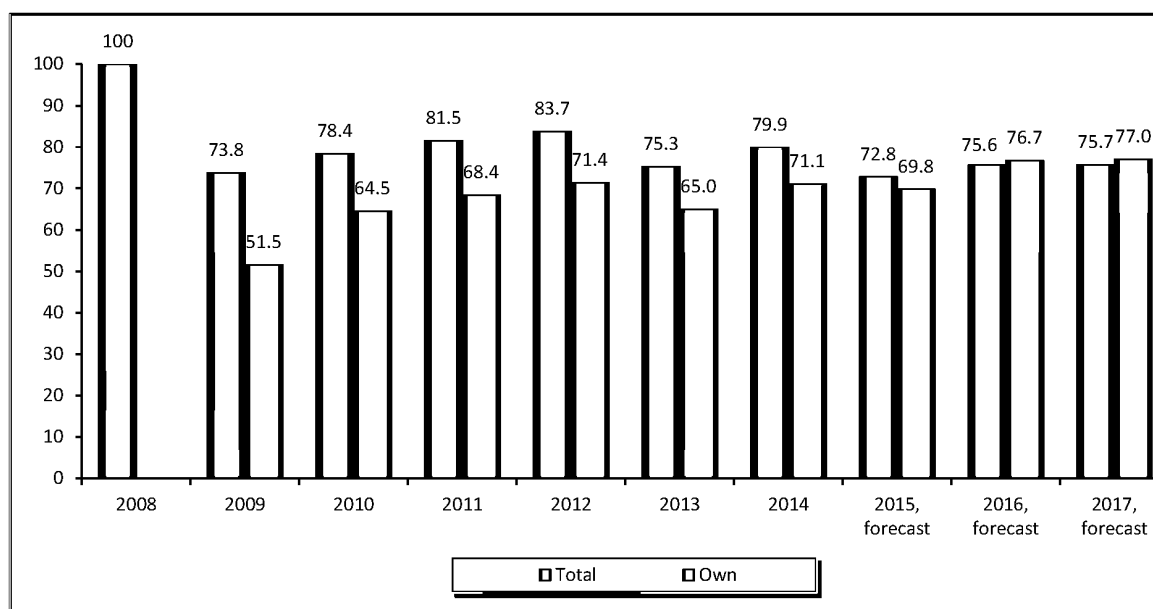
The problems that remain in the region's economy are aggravated by low recovery rate of budget revenues, which in real terms will not reach their pre-crisis level even in 2017 (*fig. 2*).

Since 2009 the change in the structure of budget revenues has become a key factor in reducing self-sufficiency in the Vologda Oblast.

It is connected with a dramatic fall in the receipts of tax on the profit of the largest corporations of ferrous metallurgy – public joint stock company Severstal (PAO Severstal), which provided more than half of the payments from this revenue source up to 2009. In the course of the forecast period this company will never regain its status as the main catalyst of profit tax collection (*fig. 3*).

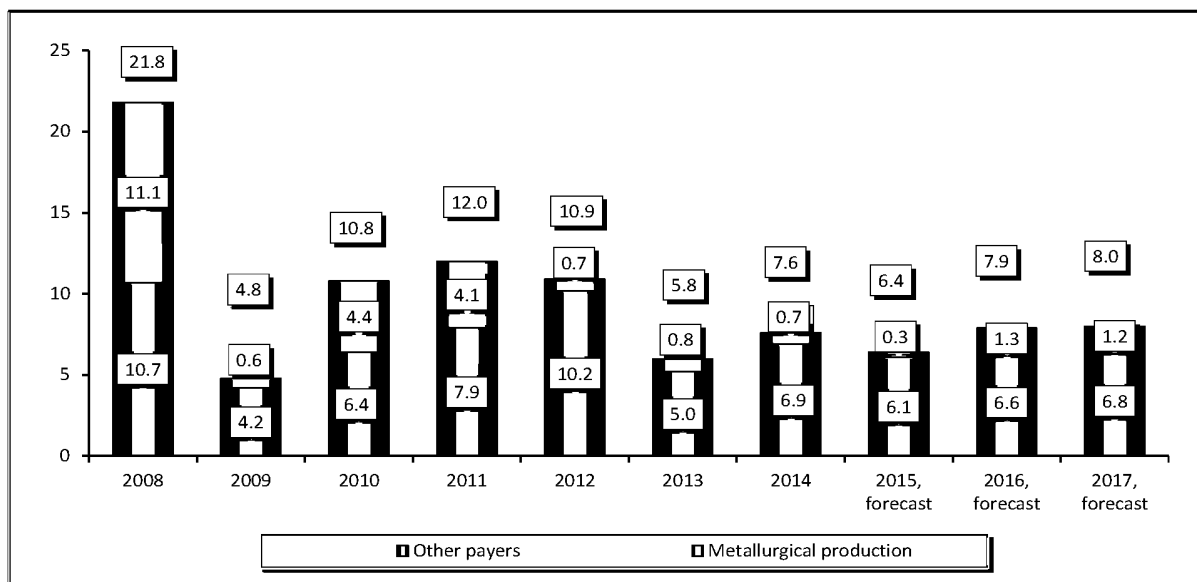
Moreover, it is noteworthy that the government does not consider metallurgical industry as a factor that influences revenues, because the revenue forecast for 2015–2017 does not include indicators for this industry. Meanwhile, metallurgy provided 36% of the total profit of business entities back in 2012 (*fig. 4*).

Figure 2. Dynamics of actual revenues of the regional budget in the Vologda Oblast in 2008–2017, in % to 2008



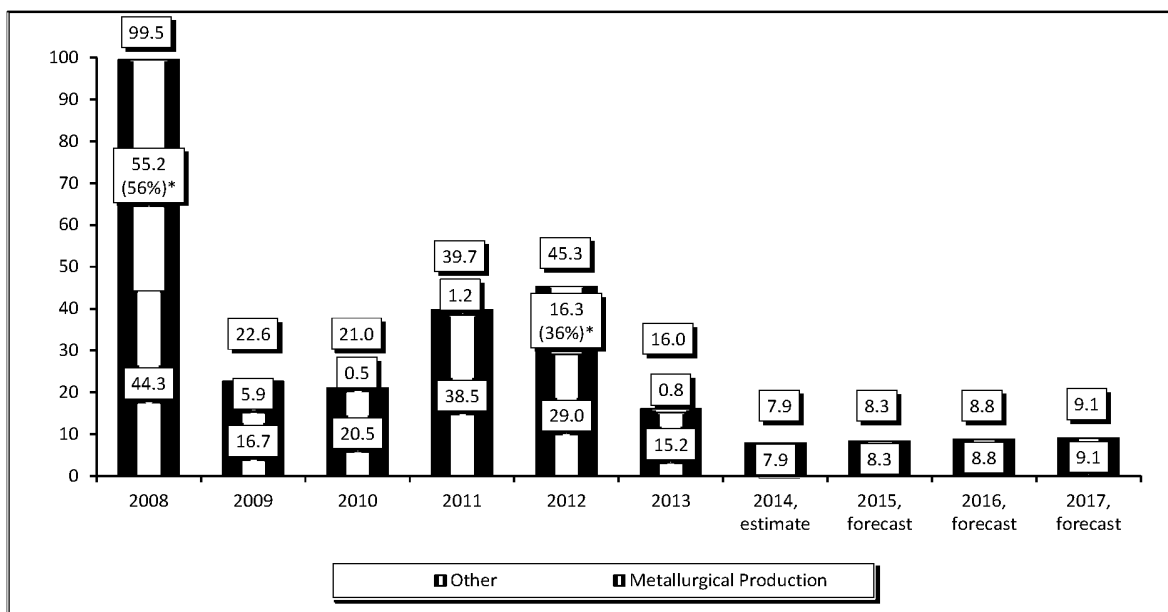
Sources: Federal Treasury [13]; Vologda Oblast Department of Finance [10]; author's calculations.

Figure 3. Dynamics of the inflow of profit tax revenues to the regional budget of the Vologda Oblast in 2008–2017, billion rubles



Sources: Federal Tax Service; [14]; Vologda Oblast Department of Finance; author's calculations.

Figure 4. Dynamics of profit before tax in the enterprises of the Vologda Oblast in 2008–2017, billion rubles



\* The share of metallurgical production in the total amount of profit in the economy is given in parentheses.

Sources: Vologda Oblast Department of Finance; author's calculations.

It should be noted that the growth of profit in the economy of the Vologda Oblast in 2015–2017 will be 15% and it will outpace the growth of GRP (6%).

However, investments in fixed capital will decrease by 23%. This means that the profit of business entities is not considered in the programs for modernization of production, but it becomes a source of capital outflow<sup>3</sup>.

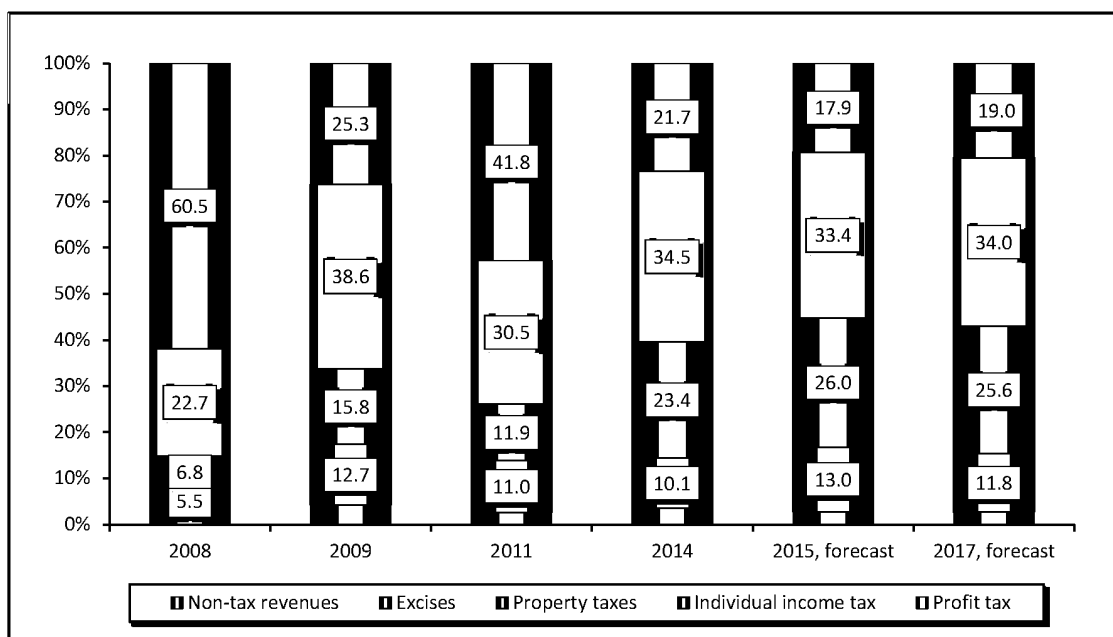
The consequences of the crisis cardinally changed the structure of the regional budget’s own revenues; this led to a significant decline in the proportion of profit tax. Moreover, the receipts of other taxes

did not compensate for the loss of profit tax in the post-crisis period.

In the upcoming budget cycle the own revenues of the regional budgets will be formed mainly out of individual income tax and property taxes – their share will be 34 and 26% respectively. The proportion of profit tax will be at the level of 19%, which is lower than in the crisis year of 2009 (fig. 5).

The slowdown in wage growth will not allow the amount of individual income tax receipts to be increased. In 2015–2017 it will grow annually by 0.5 billion rubles, which is two times lower than in 2012–2014 (tab. 3).

Figure 5. Structure of the own revenues of the Vologda Oblast regional budget, %



Sources: Federal Treasury; Vologda Oblast Department of Finance; author’s calculations.

<sup>3</sup> Unfortunately, banking statistics do not contain information on the export of capital in the regional context. According to the Central Bank, the total outflow of capital from Russia in 2014 was the largest and it reached 151.5 billion U.S. dollars (for comparison: it was 133.6 billion U.S. dollars in 2008 and 61 billion U.S. dollars in 2013).

Table 3. Individual income tax receipts to the regional budget of the Vologda Oblast and the wages in 2012–2017

Indicators	2012, fact	2013, fact	2014, fact	Average for 2012–2014	Forecast			Average for 2015–2017
					2015	2016	2017	
Individual income tax, billion rub.	9.6	10.5	12.0	10.7	12.0	13.4	14.3	13.2
To the previous year								
- billion rub.	0.8	0.9	1.5	1.1	-0.9	1.4	0.9	0.5
- %	109.5	109.3	114.7	111.2	92.8	111.5	106.8	103.7
Average monthly nominal accrued wage, rub.	22649	25127	26643	24806	27997	29703	31713	29804
Growth rate, %	111.8	110.9	106.0	109.6	105.1	106.1	106.8	106.0
Real wage, % to the previous year	106.9	104.4	98.7	103.3	98.5	101.6	102.4	100.8

Sources: Vologda Oblast Department of Finance; author's calculations.

Due to a serious reduction in self-sufficiency, the regional budget becomes more and more dependent on financial support from the federal budget in the form of inter-budget transfers and loans. For 2008–2014 the amount of this kind of support has increased in four times – from 5 to 19 billion rub. (*fig. 6*).

According to the figure, inter-budget policy from 2014 onwards makes the substitution of transfer financing with debt financing its priority. In 2015–2017 the planned amount of budget loans will exceed the amount of transfer financing almost twice.

The significant reduction of inter-budget transfers in the Vologda Oblast will become one of the main factors reducing the real revenues of the regional budget in the upcoming three year period.

As a result, the gap in the provision of the population with budget revenues will increase compared with the national average level (*fig. 7*).

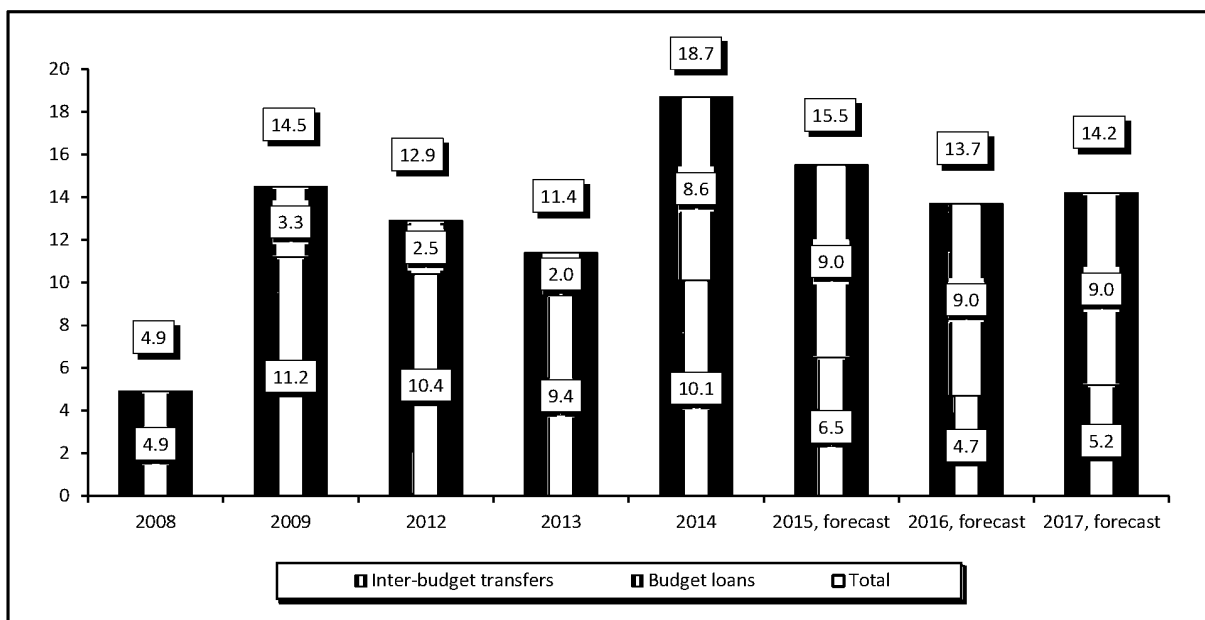
In 2015–2017 the Vologda Oblast Government has set an ambitious goal of achieving the regional budget balance<sup>4</sup> (*fig. 8*).

This task will be handled by reducing costs on all the functional items in the budget. Budget spending in 2017 will decrease by 5.6 billion rubles in current prices, and after allowing for inflation – by 11.4 billion rubles, or by 23% to the level of 2014 (*tab. 4*).

The most significant decrease of financial support is expected in the housing and utilities sector – 81%, which is determined by the decrease of expenditures on budget investments and on major repairs of objects of state and municipal property.

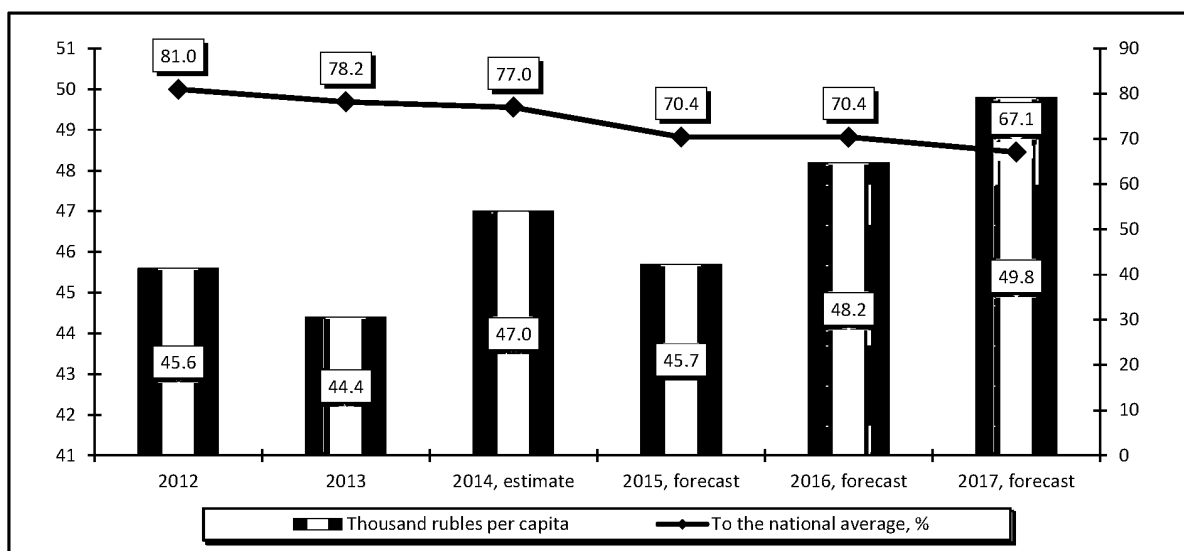
<sup>4</sup> It was based on the agreement between the Vologda Oblast and the Ministry of Finance of the Russian Federation on the provision of budget loan to repay commercial loans in the amount of 6 billion rubles. In accordance with the terms of the agreement, the regional budget for 2015–2017 must be formed without deficit, and the amount of market loans must be reduced to 50% of the amount of the budget's own revenues by January 1, 2017.

Figure 6. Dynamics of financial support from the federal budget to the regional budget of the Vologda Oblast in 2008–2017, billion rubles



Sources: Federal Treasury; Vologda Oblast Department of Finance; author's calculations.

Figure 7. Provision of the Vologda Oblast population with budget revenues\* in 2012–2017

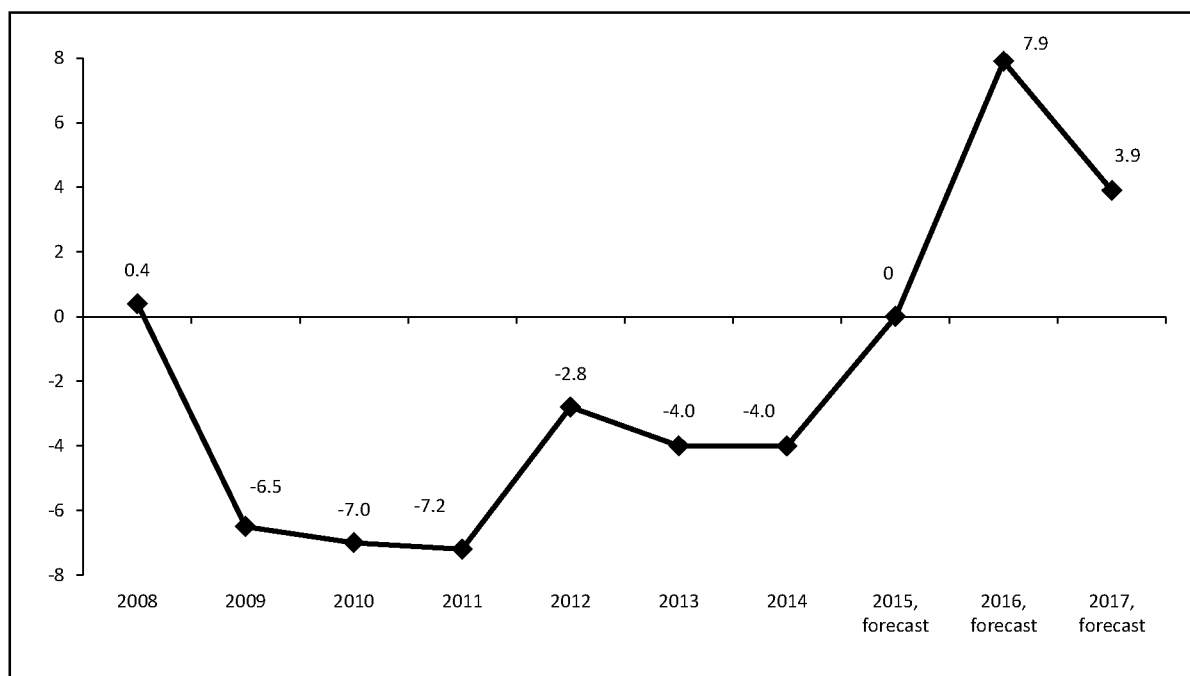


\* Data for the consolidated budget of the Vologda Oblast.

Source: author's calculations based on the data of the Federal Treasury; Rosstat; RF Ministry of Finance; the Vologda Oblast Department of Finance.



Figure 8. Dynamics of the results of execution of the regional budget in the Vologda Oblast in 2008–2017, billion rubles



Sources: Federal Treasury; Vologda Oblast Department of Finance.

Table 4. Dynamics the regional budget expenditures in the Vologda Oblast in 2014–2017, million rubles

Expenditures	2014	Forecast						2017 to 2014, %	
		2015		2016		2017		Nominal	Real*
	Nominal	Real*	Nominal	Real*	Nominal	Real*			
Expenditures, total	49046	43005	40305	38043	34242	43470	37669	88.6	76.8
National expenditures	2367	2396	2246	1845	1660	1892	1640	79.9	69.3
<b>National economy</b>	<b>9196</b>	<b>6437</b>	<b>6033</b>	<b>5540</b>	<b>4987</b>	<b>6549</b>	<b>5675</b>	<b>71.2</b>	<b>61.7</b>
- agriculture	2628	1232	1155	744	670	924	801	35.2	30.5
Housing and utilities	1825	863	809	762	685	404	350	22.1	19.2
<b>Social sphere</b>	<b>32789</b>	<b>29831</b>	<b>27957</b>	<b>26238</b>	<b>23617</b>	<b>29697</b>	<b>25734</b>	<b>90.6</b>	<b>78.5</b>
- education	13442	10716	10043	9945	8951	11353	9838	84.5	73.2
- culture	781	517	485	465	418	498	432	63.7	55.3
- healthcare	7735	7804	7314	6604	5945	7433	6441	96.5	83.6
- social policy	10700	10590	9925	9131	8219	10328	8949	96.5	83.6
- physical culture and sport	266	203	191	93	84	85	73	31.9	27.6

\* In the prices of 2014.

Sources: Federal Treasury; Vologda Oblast Department of Finance; author's calculations.

National economy loses 40% of the support. In particular, expenditures on agriculture in 2017 will be just 30% from the level of 2014, which will limit the development of import substitution.

The prospects of allocating funds to the social sphere seem no less frustrating: expenditures on education are reduced by 27%, on healthcare and social policy – by 16%, on cultural events – by 45%, on physical education and sport – by 72%.

The need to achieve balance and the structure of budget expenditures that is oriented excessively toward the social sphere are a telling example of another problem of the regional budget, which is associated with a progressive decrease in capital investment. The amount of budget investment over three years will be reduced by 2.5 billion rubles, or about four times compared to the level of 2014 (*fig. 9*). It seems as if the Vologda Oblast Government has made a choice in favor of the final optimization of capital expenditure<sup>5</sup>.

Despite the unprecedented optimization, the achievement of a deficit-free regional budget seems unlikely, in our opinion.

First, the practice of forming budget surplus has been implemented for several years. The actual budget process turns out to be very different from the scenario and makes it necessary to introduce multiple adjustments into the budget execution results. For example, the budgets for 2014 and 2015 were originally declared to have

surplus, but they became deficit-ridden after the formation of the main characteristics of the next budget cycle (*tab. 5*).

Second, the implementation of activities under the presidential decrees of May 7, 2012 that have virtually become unfunded social instructions to the regions will require more than 16 billion rubles, while the real funds allocated for these purposes amount to 8.7 billion rubles, that is, half of the sum required. A particularly acute shortage of financial resources is expected in 2015 (*tab. 6*).

If there is no adequate support from the federal government, then the Presidential decrees will be executed, as the practice of previous years has shown, by eliminating the budget institution network and reducing the number of employees<sup>6</sup>.

Third, as a result of this imbalance in inter-budget relations, characterized by the increase in the number of federal powers<sup>7</sup> transferred to the regions and a simultaneous reduction of non-repayable financial assistance from the federal budget, the coverage of the regional budget expenses by the own revenues in 2015–2017 will be 88% on average.

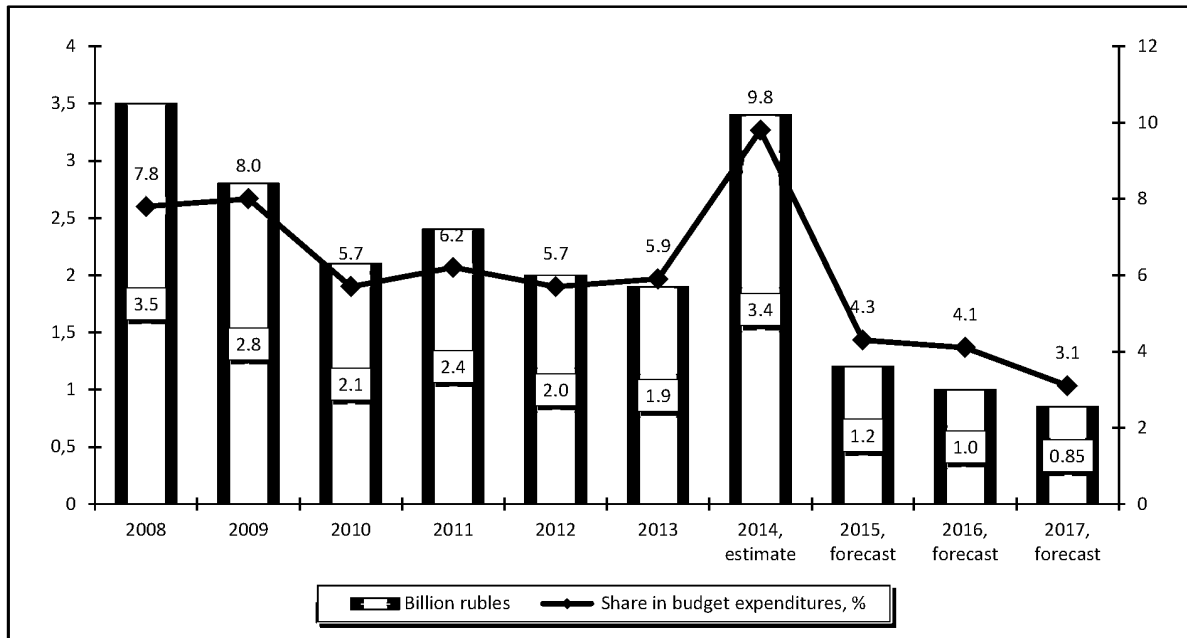
Fourth, local budgets still remain highly dependent on the transfers from the regional budget, which is one of the main causes of its deficit. After a new system of local government was introduced in 2006, the regional budget allocates over 40% of its expenses to inter-budget transfers to municipalities.

<sup>5</sup> The Vologda Oblast ranked 7th in the Northwestern Federal District in 2013 by the share of funds allocated to the formation of the budget of development. Given the fact that the average district level was 10.3%, the regional budget expenditures on the investment amounted to 5.9%. This figure amounted to 10.7 and 6.5% even in the “highly subsidized” Novgorod and Pskov oblasts, respectively.

<sup>6</sup> According to the Department of Finance, 98 educational and cultural institutions were closed down and 1607 people discharged in the Vologda Oblast in 2012–2013.

<sup>7</sup> From 2004 to 2013 the number of federal powers transferred to the regional level has increased almost three times. Thus, the amount of taxes assigned to the budgets of the regions has reduced from seven to three.

Figure 9. Dynamics of capital investments of the regional budget of the Vologda Oblast in 2008–2017, in the prices of 2008



Sources: Federal Treasury; Vologda Oblast Department of Finance; author's calculations.

Table 5. Change in the forecast parameters of the results of execution of the regional budget in the Vologda Oblast, million rub.

Law	2014	2015	2016
Law on the budget for 2012–2014	5920.1		
Law on the budget for 2013–2015	3215.5	5345.4	-2014.8
Law on the budget for 2014–2016	-3212.1	-2014.8	-1486.0
Law on the budget for 2015–2017		0	+7898.3

Table 6. Forecast of the expenditures of the Vologda Oblast regional budget on the implementation of the RF President' decrees in 2015–2017, million rubles

Indicators	2015	2016	2017	Total
Demand for funds	5400.8	5304.1	5663.2	16368.1
Provided for in the budget	1730.3	3068.3	3913.7	8712.3
Lack of funds				
- million rub.	3670.5	2235.8	1749.5	7655.8
- %	32.0	57.8	69.1	53.2

Source: Vologda Oblast Department of Finance

Fifth, in 2015–2017 the planned expenditures on the return of commercial and budget loans obtained in previous years to finance the budget deficit will reach 53.7 billion rubles, which will fundamentally change the actual results of budget execution<sup>8</sup> (*tab. 7*).

According to our calculations, the actual deficit of the regional budget will reach 19 billion rubles in 2017; it will be necessary to direct almost half of the own revenue sources to its elimination. In conditions of a limited self-sufficiency of the budget the financing of the deficit is

likely to cause the need for new loans or sequestration.

Sixth, the balance of the regional budget cannot be achieved under the conditions of high debt load.

When forming a balanced budget, the government expects to reduce the acute debt load. Indeed, the absolute amount of public debt over the forecast period will decrease from 35 billion rubles in 2014 to 23.6 billion rubles in 2017; but it will remain significant and correspond to 57% of the total amount of the own revenues of the regional budget (*tab. 8*).

Table 7. Actual results of execution of the regional budget in the Vologda Oblast in 2014–2017, million rubles

Indicators	2014	Forecast		
		2015	2016	2017
Deficit (-), surplus without expenditures on loans repayment	-3973	0	7898	3856
To the budget's own revenues, %	-11.4	0	19.4	9.2
Expenditures on loans repayment*	24471	11563	19092	23019
Real deficit (-), surplus	-28444	-11563	-11194	-19163
To the budget's own revenues, %	-81.4	-32.2	-27.5	-45.7

\* Approved by the law on the oblast budget for 2014–2016

Table 8. Dynamics and structure of the public debt of the Vologda Oblast in 2014–2017, billion rubles

Indicators	2014, fact		2015, forecast		2016, forecast		2017, forecast		2017 to 2014, %
	Billion rub.	%	Billion rub.	%	Billion rub.	%	Billion rub.	%	
Public debt, total	34.9	100.0	35.2	100.0	27.3	100.0	23.6	100.0	67.6
Bank loans	14.0	40.1	20.6	58.6	19.1	70.0	20.6	87.4	147.1
Budget loans	12.6	36.1	8.5	24.2	4.2	15.4	0	0	0
State guarantees	3.4	9.6	3.3	9.4	3.1	11.4	3.0	12.6	88.2
Securities	4.9	14.1	2.8	7.8	0.9	3.2	0	0	0
Debt load, %*	99.8		99.3		68.3		57.2		-43.3

\* Debt load is measured by the ratio of the amount of public debt to the budget's own revenues.  
Sources: Vologda Oblast Department of Finance; author's calculations.

<sup>8</sup> Despite repeated appeals of heads of the Russian Federation subjects (in particular, the Vologda Oblast Governor O.A. Kuvshynnykov) to the Ministry of Finance of the Russian Federation with a request to introduce amendments in the accounting for expenditures on loans repayment, these expenditures are included not in the expenditure part of the budget, but in the sources of deficit funding, which leads to a distortion of its actual amount.

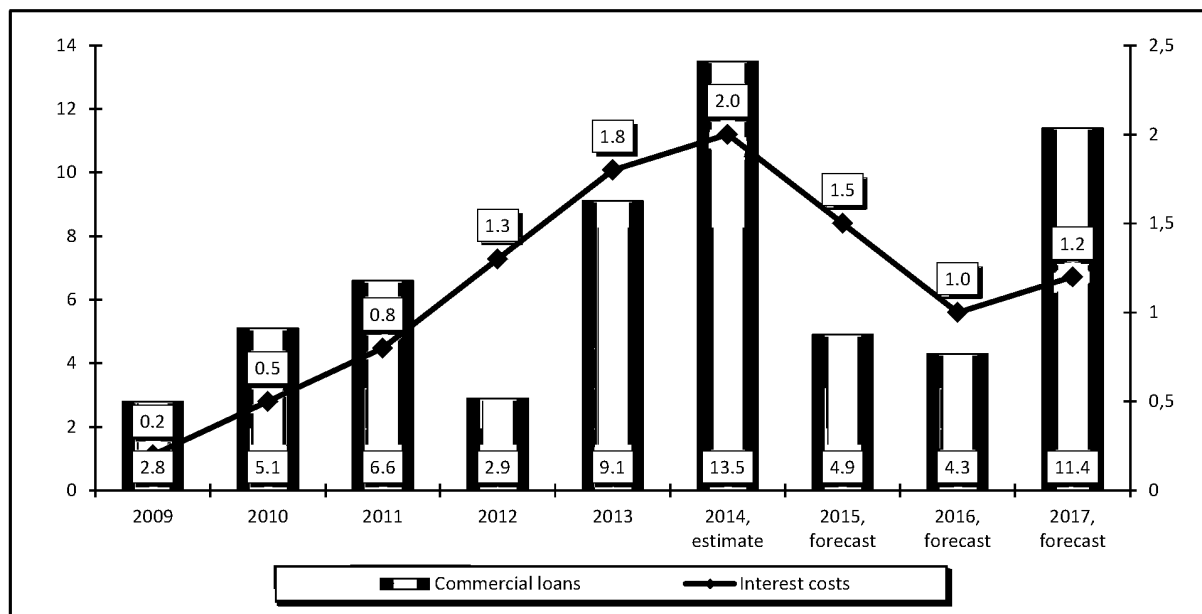
The level of commercial debt in the structure of debt obligations will continue to grow and will reach 87.4% at the end of the budget cycle, thereby creating additional risks to the budget's debt sustainability. Moreover, after the substantial decrease in the amount of attracted loans in 2015–2016, the oblast government is planning to attract new bank loans in 2017, which will lead to the growth of loan servicing (*fig. 10*).

If we sum up the expenses on the repayment and servicing of loans, their amount will exceed other major areas of funding of the regional budget. In fact, these expenses have become a priority (*fig. 11*).

It is obvious that in the near future the regional authorities will not be able to change the situation cardinally in the sphere of debt policy; and the diversion of budget funds to the repayment of loans and to interest payments will aggravate the risks concerning the execution of priority expenditure obligations.

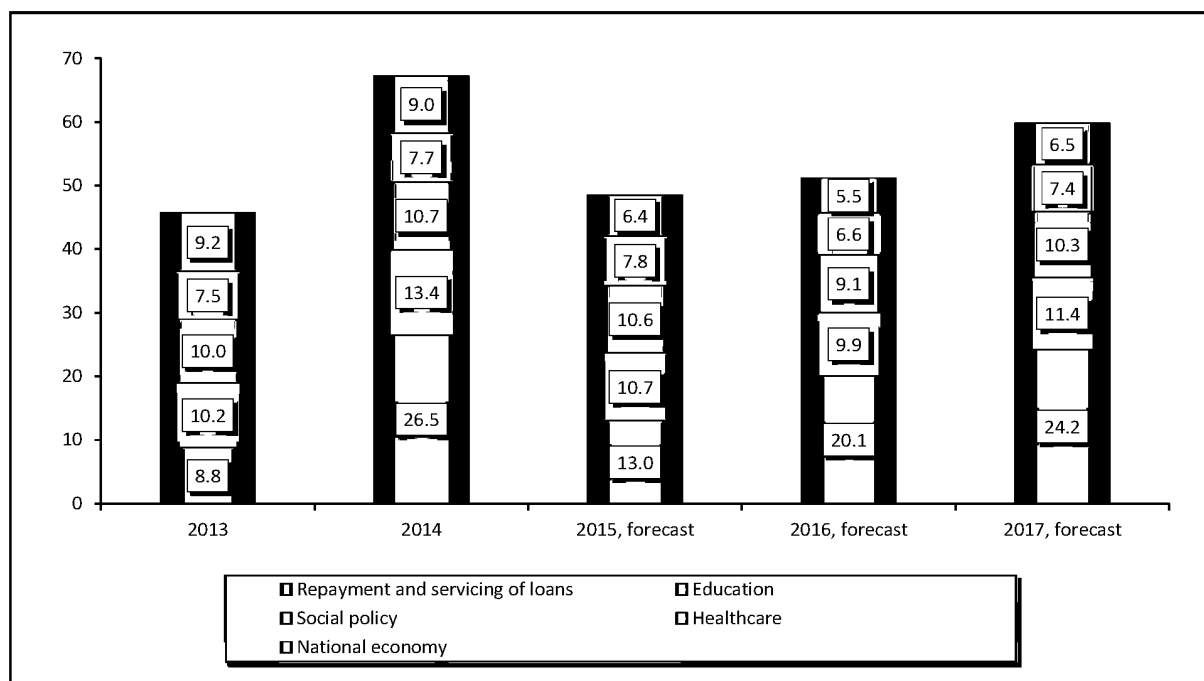
The list of flaws in the next three-year budget can be continued, but after all, in our opinion, they are predetermined by flaws in the fiscal policy pursued in the country; this policy does not serve as an essential tool in the territorial development management, but it plunges Russian regions deeper in the budget crisis.

Figure 10. Dynamics of attracted commercial loans and interest costs of the regional budget of the Vologda Oblast in 2009–2017, billion rubles



Sources: Federal Treasury; Vologda Oblast Department of Finance; author's calculations.

Figure 11. Main functional expenses and expenses related to the repayment of loans of the regional budget of the Vologda Oblast in 2013–2017, billion rubles



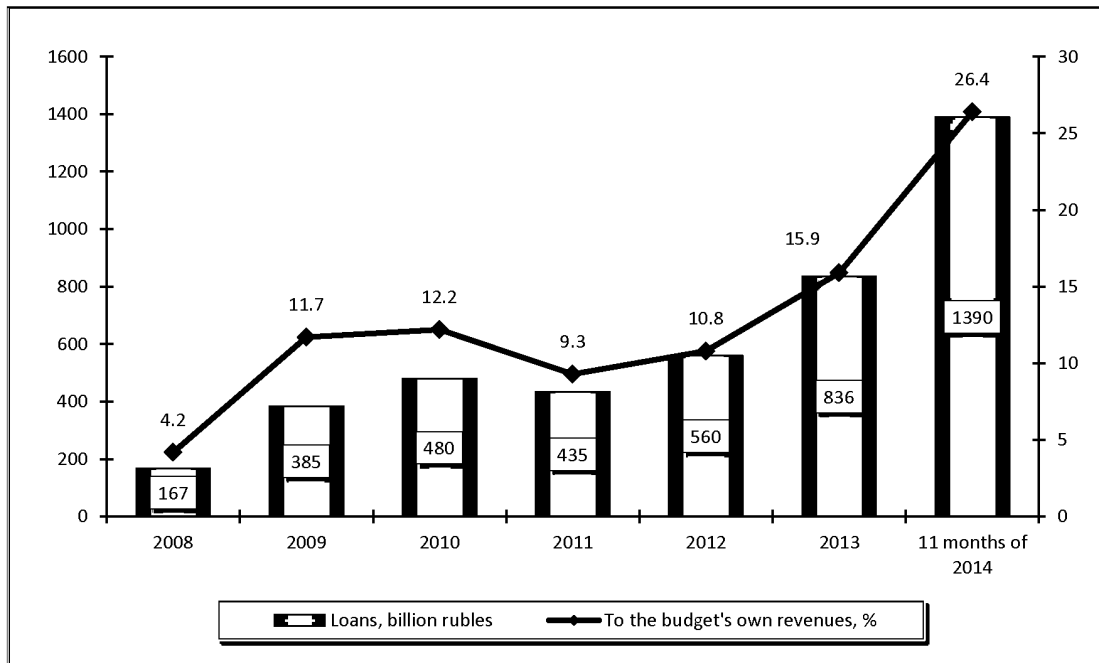
Source: author's calculation based on the data provided by the Vologda Oblast Department of Finance

What other reason can there be to explain that only ten RF subjects are self-sufficient (they do not receive subsidies for equalization of budget sufficiency), that the deficit of regional budgets for 2013–2014 has reached historic highs, exceeding the planned values by several times [5], and the majority of regions are on the brink of bankruptcy, continuing to borrow funds to be used for covering current expenses rather than for development? From January to November 2014 the debt load of Russia's constituent entities has increased by 75%, exceeding one trillion rubles for the first time (fig. 12).

The amount of loans attracted is second only to the regional budget expenditures on education and social policy.

The standards for the transfer of revenues to local budgets established by the Budget Code of the Russian Federation do not ensure the implementation of the powers assigned to regions. Thus, handling the issue of federal budget deficit by shifting the government spending to lower levels, the central government forces regional authorities to form their budgets so that they initially had the limit values of debt obligations. For example, in 2015 the debt load of the Northwestern regions of

Figure 12. Dynamics of loans raised by the subjects of the Russian Federation in 2008–2014



Sources: Federal Treasury; author's calculations.

Table 9. Upper limit of public debt in the regional budgets of NWF subjects in 2014–2015

Constituent entity	Approved for 2014		Approved for 2015	
	Billion rub.	To the budget's own revenues, %	Billion rub.	To the budget's own revenues, %
Saint Petersburg	14.6	3.8	79.6	20.0
Leningrad Oblast	22.0	33.8	22.9	32.2
Murmansk Oblast	20.3	54.8	25.2	63.7
Kaliningrad Oblast	21.2	79.4	19.9	74.1
Novgorod Oblast	17.2	90.7	16.0	81.0
Republic of Komi	28.7	52.1	51.5	89.5
Vologda Oblast	34.9	100.5	35.2	97.9
Arkhangelsk Oblast	35.6	80.2	40.7	98.1
Pskov Oblast	14.7	99.5	14.7	98.6
Republic of Karelia	19.0	102.4	20.1	107.3

Sources: laws of the RF constituent entities on the regional budget for 2014–2016 and 2015–2017; author's calculations.

the Russian Federation, except for Saint Petersburg and the Leningrad Oblast, will approach a critical level, it will exceed this level in the Republic of Karelia (*tab. 9*).

The acute debt crisis in the majority of the Russian Federation subjects is caused in many respects by a delayed response of the central government to the growing risks. Only in July 2014 the RF Government adopted a decision on the transformation of commercial loans into budget loans issued at low interest rate<sup>9</sup>.

Speaking at the expanded board meeting of the RF Ministry of Finance on April 8, 2013, V.I. Matvienko, Chairman of the Federation Council, asked its officials a fair question: “The Ministry of Finance should not stand on the sidelines. Why haven’t we stopped the unrestrained borrowings of some regions, which are now virtually bankrupt?” [2].

Unfortunately, Russian Government still has not proposed any system-wide measures to solve the budget crisis in the regions. On the contrary, the “Program for improvement of public (state and municipal) finance management efficiency for the period up to 2018” states quite openly that “the majority of state powers should be assigned to the subjects of the Russian Federation as their own powers”. It seems that the government intends to increase the efficiency of regional finance management through the gradual transfer of

funding of its functions to the RF subjects; but it does not realize what can happen in case of the growth in the number of not-collateralized liabilities of the regional budgets, whose burden is already excessive [16].

Conceptual aspects of the actions necessary to correct the fiscal policy, have been substantiated in a large number of scientific works [1, 3, 4, 6, 7, 15, 17].

In our opinion, the priority measures to be implemented at the regional level should provide adequate legislative support to sub-national budget systems. An extended list of these measures can be represented in three blocks.

1. Transfer of additional tax revenues<sup>10</sup> to the regional level:

- assignment of the whole amount of income tax receipts to the budgets of the regions<sup>11</sup> on the grounds that the share of this payment does not exceed 3% in the formation of the federal budget revenues;
- increase of the standard VAT rate (for example, from 18 to 20%) or cancellation of VAT refund from the federal budget to exporters of natural resources, and the allocation of additionally collected VAT to the increase of alignment subsidies to the Russian Federation subjects or their distribution between the regions on a per capita basis, like, for example, in Germany;

<sup>9</sup> In 2014 the average rate on commercial loans obtained by the subjects of the Russian Federation were 10.8–13.5 percent, on budget loans – ¼ of the refinancing rate of the Central Bank (budget loans on the replacement of bank loans are issued at the rate of 0.1% per annum for financially weak regions like the Vologda Oblast).

<sup>10</sup> In accordance with the Law on the Federal Budget, 72.4% of the revenues of Russia’s budget system will be centralized at the federal level in 2015–2017.

<sup>11</sup> In accordance with the Budget Code of the Russian Federation, 2% of income tax, calculated at the rate of 20%, goes to the federal budget and 18% – to the budget of the constituent entity of the Russian Federation.



– introduction of luxury tax – a measure, which the government still hesitates to take<sup>12</sup>.

2. Increase in the amount of financial support from the federal budget. Priority in its allocation should be given to transfers rather than to budget loans, because the situation will repeat itself if new loans are provided to repay existing debt.

This situation can be handled by revising the current procedure of using targeted transfers. The uneven allocation of inter-budget transfers by the federal center in the course of the year<sup>13</sup> leads to the fact that Russia's constituent entities cannot dispose of them timely; as a result, the remaining funds are returned to the federal budget in accordance with the budget legislation. In the Vologda Oblast the amount of returns for 2008–2013 has increased by 8.4 times – from 56 to 476 million rubles.

The central government should pay more serious attention to the issues related to co-financing of investment programs of territories. According to the Federal Treasury data, the amount of subsidies allocated for capital expenditures to the RF subjects from the federal budget in 2012–2014 reduced from 199 to 56 billion rubles, or in 3.6 times (in the Vologda Oblast – from 825 to 184 million rubles, or in 4.5 times). Of course, such a drastic reduction of investment transfers will create

<sup>12</sup> The necessity to introduce luxury tax in the first half of 2013 was highlighted by the RF President in his address to the Federal Assembly on December 12, 2012.

<sup>13</sup> According to our calculations, in 2011–2013 more than 30% of federal transfers to the regional budget of the Vologda Oblast were made in the 4th quarter, which is comparable with the average indicator for the subjects of the Russian Federation.

long-term risks for sustainable growth in taxable capacity.

3. Inventory of expenditure powers with the subsequent transfer of part of them to the federal level.

According to the estimates by the Institute of Economics of the Ural Branch of RAS, no powers with the 100% provision with financial resources have been transferred from the federal level to the regions and municipalities since 2000 [18].

The social burden of regional budgets could be relieved considerably, if the expenditures on the payment of insurance contributions for compulsory health insurance of non-working population were transferred to the federal level. For example, these expenditures, prevail in the structure of regional budget expenditures on health care in the Vologda Oblast, and make up 56% (in Russia – 42%).

According to our estimates, the implementation of the above priority measures alone will increase the annual revenues of regional budgets on average by 1.2 trillion rubles (*tab. 10*).

When implementing these measures it is necessary to make a profound revision of the Tax Code and Budget Code of the Russian Federation in order to change the approaches to the taxation of profit of big business, to establish foreign exchange control, to introduce a progressive individual income tax scale, to restore order in the subsurface management, to abolish tax privileges and preferences for highly profitable business entities, etc.

Of course, the practical implementation of these measures largely depends on the efforts undertaken by the federal center.

Table 10. Additional revenue sources of regional budgets in the Russian Federation subjects, billion rubles per year

Source	Estimate
Transfer of the entire amount of profit tax collected in the region	350*
Increase in VAT rate or cancellation of VAT refund to commodity exporters	400–450*
Introduction of luxury tax	200–250**
Leaving the unused target inter-budget transfers in regional budgets	35–40*
Transfer of the authority to pay insurance contributions for compulsory medical insurance on non-working population to the federal level	500*
Total	1135–1240

\* Estimated on the basis of the dynamics of the indicator for 2011–2013.  
 \* According to the draft law elaborated by the RF State Duma Deputy, Doctor of Economics N. O. Dmitrieva in collaboration with representatives of the party “Just Russia”, the real estate worth more than 30 million rubles and the vehicles worth over 3 million rubles are subject to luxury tax. It is about 200 thousand apartments and detached houses and about 100 thousand vehicles. And their owners do not belong to the middle class; they make up only about 0.01% of the population, and they are the super-rich Russians who own luxury objects. In their volume, the receipts from luxury tax paid by a small number of wealthy individuals will be comparable to tax revenues from all simplified regimes, paid by millions of small entrepreneurs and farmers.

However, this does not relieve the regional authorities from the responsibility to conduct a responsible fiscal policy. In relation to the Vologda Oblast the main directions of such a policy should include the following:

**First**, an active search for all possible sources of increase the collectability of tax revenues. According to the Vologda Oblast Department of Finance, at the end of 2014 the debt of the region’s taxpayers on the payment of taxes to the budget system of the Russian Federation exceeded 2 billion rubles, and the budget lost 5 billion rubles due to the implementation of “off-the-books” labor remuneration schemes by employers. These funds would be quite enough not only to cover the current deficit, but also to implement the inaugural decrees of the President in 2015.

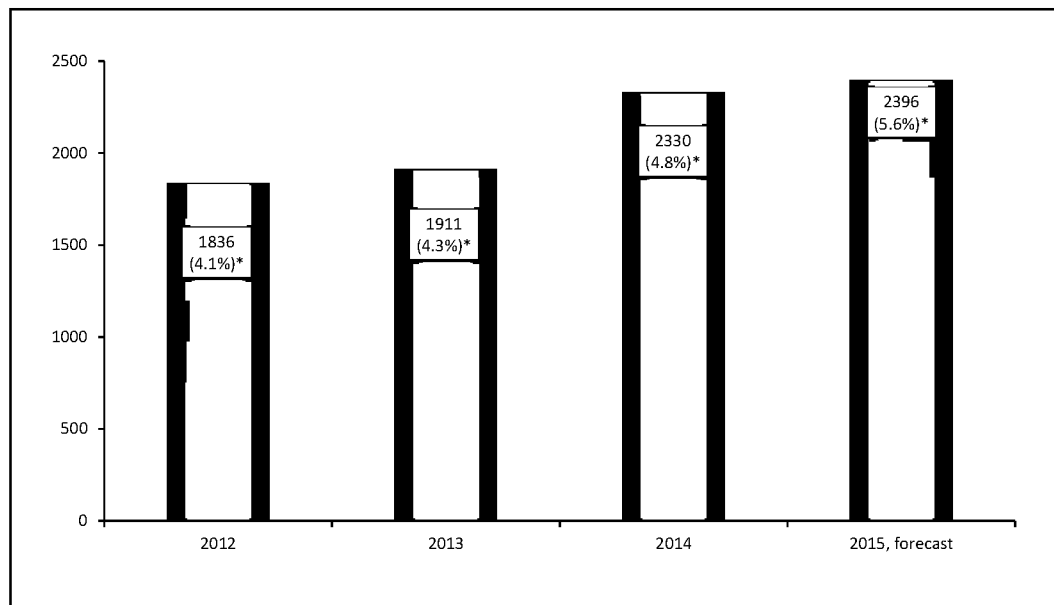
In order to enhance the mobilizing function of non-tax revenues it is necessary to implement a set of administrative measures, in particular: to revise the

legislative framework; to index the rates of certain types of payments; to exclude the transfer of the oblast property to federal structures for its free use.

**Second**, further optimization of budget expenditures on management. Dynamic increase in state expenditures, unlike other expenditure items, indicates the potential for their reduction (*fig. 13*).

According to the latest data provided by Vologdastat, in January – September 2014 the number of employees of state administration bodies in the oblast increased from 9.8 to 16.9 thousand people, i.e. by 1.7 times in comparison with the same period of the previous year. The average salary of an employee of administrative staff, including the entire regular staff, was 41.7 thousand rubles, the average salary in economy being 25.7 thousand rubles. Salaries of the Vologda Oblast Government officials, holding public office, reached 301 thousand rubles and 12 times exceeded the regional average.

Figure 13. Expenses under the heading “federal issues” in the regional budget of the Vologda Oblast in 2012–2015, million rubles



\* The share of expenditures in the total expenditure part of the regional budget is given in parentheses.

Sources: Vologda Oblast Department of Finance; author's calculations.

**Third**, strengthening the responsibility of administrators of budget funds for improper level of cash execution of expenditures. In the conditions of a chronic budget deficit about two billion rubles of approved regional budget allocations is not utilized every year. Budget accounts receivable, the amount of which at the beginning of 2014 reached 1.1 billion rubles, arouses serious concern. Almost the whole sum falls on advance payments on the contracts and on the payments on loans granted from the regional budget.

Strengthening the financial foundations of the regions should become a core aspect of increasing the efficiency of public administration.

If the policy of fiscal consolidation is continued, it will inevitably lead to a lingering debt crisis of territorial budgets, and, ultimately, to the default in the regions and economic destabilization. At the same time, it is necessary that Russia's regions consolidate their efforts aimed to change the policy of the federal center.

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