



Decentralization in the Russian Federation

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Introduction

The decentralization that took place in the Russian Federation in the course of economic and political reforms of the 1990s was a spontaneous process that lacked a clearly defined strategy. However, by the end of the century it had some significant achievements to its credit. One such achievement was that regional and local authorities were granted the right to independently plan their respective budgets. In line with the reform concept, a significant portion of expenditure responsibilities were assigned to RF regions and municipalities. At the same time the federal center retained the majority of revenue sources – a feature that is more like to be found in unitary states.

It is the purpose of this paper to see how far Russia has traveled along the decentralization road and which direction it will follow in the future.

In spite of the fact that there is no quantitative indicator that can be used as the tool to adequately measure the decentralization of responsibilities and the degree of autonomy of subnational authorities, we have nevertheless made an attempt to assess various decentralization aspects by analyzing Russian fiscal data and legislative framework.

At the first glance, the quantitative characteristics of the Russian fiscal system testify to significant decentralization. However, a more thorough qualitative analysis shows that subnational budgets have little or no fiscal autonomy.

Obviously, centralized delivery of public services in Russia whose regions differ greatly in terms of geography, climate and social-demographic characteristics is not efficient. The federal center has made its first step towards decentralization by assigning part of expenditure responsibilities to the regional and local levels of government. Now it is time to make the next step, namely to allocate revenue sources to the RF subjects and municipalities.

Decentralization of Public Functions

The main question of decentralization can be formulated in the following way: Is the decentralized system of governance more effective and efficient than the centralized one? Since we are talking about the system of public governance the question can be formulated differently: Provided budget resources are fixed, will the needs of public service recipients be satisfied better by a decentralized government than under a centralized system?

There are two main arguments to support the decentralization of public functions:

1. Decentralization of responsibilities associated with provision of public services makes budget spending more effective since it brings public authorities closer to the population making the authorities accountable to the electorate and take a better account of their preferences.
2. Decentralization of budget revenue mobilization responsibilities makes it possible to define the specifics and composition of the tax (revenue) base thus ensuring higher tax and other revenue collections.

On the face of it, the arguments for decentralization of public expenditure functions outweigh those supporting decentralization of revenue mobilization functions. Indeed, the closer the government comes to the taxpayer, the more likely that the latter's needs will be taken care of. On the other hand, the chances of giving individual tax privileges also rise and are accompanied by enhanced stimuli to weaken the tax burden on local taxpayers with the aim to compensate these tax break through intergovernmental grants or to export the tax burden.

Actually, the arguments favoring decentralization of expenditure functions might also be given a second thought. Indeed, is it always good, in terms of public governance, to pay as much attention to local specifics and preferences as possible?

There are not so many public functions that can be performed directly by the central office of a public agency. Practically any public function, be it school education, health care, law and order or weather monitoring, can be carried out either by field branches of the central agency or by subdivisions of subnational¹ governments.

By decentralization of a certain public function in the course of a reform we mean that the responsibility for its performance is transferred from the central authorities' field branch

¹ The notion of decentralization applies both to federative and unitary states. Any provision of this article referring to subnational (regional and local) authorities in federative states are also applicable to local authorities in unitary states.

to the subnational (regional, municipal) public authorities. This may happen when a central agency's branch is put under control of a subnational elected government. Thus, during the 1990s reform in the Russian Federation the Ministry of Finance's field branches were made subordinate to regional governments.

Do costs of the budgetary system as a whole increase when a public function is assigned to a lower level government? - One cannot give a simple yes-or-no answer to this question because, on the one hand, administrative costs in a ramified, multi-level hierarchical system may be very high and in no case lower than in a flat, decentralized organization and, on the other hand, in the latter case a certain duplication of functions takes place.

As far as the satisfaction of a need in public service is concerned, it may even decrease as the result of decentralization. One should decide about a criterion to measure public needs satisfaction: should it be a local or a national need? For instance, will the state as a whole benefit from conscription campaign being the responsibility of regional and local authorities whose policy is oriented on satisfaction of wishes of their electorate rather than the nation at large?

In terms of efficient delivery, the optimal degree of decentralization may differ from service to service. The responsibility for delivery of those functions whose standards should be the same throughout the whole country irrespective of local preferences (national security, money issue, statistical recording, weather forecasts) should be assigned to the central (federal) government and its field branches. Other functions associated mostly with socially important services and social protection would probably be delivered better at the subnational level.

However, the latter thesis may cause objections. Indeed, those regions and jurisdictions whose population is in the greatest need of a social safety net usually have low fiscal capacity indicators and are unable to provide social protection services.

Also, some socially important functions may have different value in the eyes of the state as a whole and local authorities. For instance, the recently proposed compulsory 12-year school education may seem important to the central government but contradict the interests of a municipality that has no funds to support the school or does not need workforce with knowledge of foreign languages or computer skills.

One has to admit that practically all socially important functions have a redistributational character; in other words, they provide access to public services of a quality that is guaranteed by the state to all the citizens irrespective of their income level. But all the

responsibility to deliver redistributive functions cannot be assigned to the subnational level since, as was noted above, those jurisdictions whose population needs social protection the most usually have no resources to be redistributed. Besides, provision of services of standard guaranteed quality to the whole population presupposes that the quality standards are determined by the federal center rather than at the subnational level, which means that the federal government should also participate in delivery of socially-oriented services by means of setting the standards and redistribution of funds across jurisdictions.

So, the most efficient decentralization from the point of view of public governance may be viewed differently depending on the specific functions, such as:

- (a) functions associated with revenue mobilization, and
- (b) functions that have to do with public service provision.

Also, in the latter case the efficiency of decentralization will depend on

- national or local significance of a function (spillover effects);
- specific aspect of function delivery: legislative regulation, administration/provision or financial support.

Methods of Measuring Decentralization

In principle, there are two ways to evaluate decentralization, i.e. by using either a qualitative or a quantitative approach. The qualitative scale shows where decentralization is stronger or weaker, and the subjects of comparison are sorted by that criterion. The comparison effort may include various countries or different development stages of the same country. The quantitative approach that is based on statistical evaluation may appear to be more precise and reliable. However, quantitative measures are prone to oversimplification and may misrepresent the actual degree of public functions decentralization. Thus, to assess decentralization it is desirable to use both approaches.

Decentralization of Expenditures

When measuring decentralization of a specific government function or service it is necessary to answer the following three questions:

1) Which level of government is responsible for regulating the delivery of this service? Regulation here also includes determining the requirements concerning the volume, quality and accessibility of public services, physical and financial standards, level of spending and its structure;

2) Which level of government will provide the funds necessary for the delivery of the service or execution of the government function?

3) Which level of government will execute the function, render the service, pay social allowances etc. from its own funds or from a transfer received from a higher government?

In case of some government functions, all these responsibilities may be assigned to a single level of government. Typically, these functions include national defense, national security and foreign policy that are assigned to the central government.

In other cases, the responsibility for developing uniform standards and financing may be the task of the central government while the subnational governments will deliver the service in question. For instance, the size of the child allowance in the Russian Federation is established by the federal law and the federal government provides the funding by allocating money to the regions; the actual payments, however, are made by regional and local authorities. Therefore, legislative framework (regulation) and funding of this function are centralized while its execution is decentralized.

There are also government functions regulated by the central government while financing and provision of services are the responsibility of regional (local) authorities. This is illustrated by the way social support of public employees is organized in the Russian Federation. One of the federal laws that regulate remuneration of public employees is the Decision of the RF Government # 785, dated October 14, 1992, *On Differentiation of Public Employees' Wages on the Basis of the Uniform Wage Scale*. There are also various laws that establish privileges for members of individual professions (military servicemen, employees of public prosecutor's offices, tax and customs officers, judges etc.). Until recently, these laws had been implemented and financed in Russia by the regional and local governments, even though the laws themselves are federal regulations.

Quantitative Measurement of Expenditure Decentralization

One of the indicators to measure decentralization of government functions is the share of federal, regional or municipal expenditures (total expenditures less grants transferred to other governments) in total spending of the budgetary system.

Unfortunately, lack of reported data on the size of the public sector does not allow to assess properly the decentralization in Russia by quantitative methods. Usually, quantitative assessments use data on the general government that includes all tiers of government and of various funds. In Russia, extra-budgetary (social) funds are huge, but they are not reflected in the consolidated budget. Also, fiscal reports do not include expenses and receipts of numerous public enterprises.

Table 1 demonstrates the shares of governments of different tiers in Germany, Canada, USA and Russia in total government spending. For comparison reasons, expenditures of the Russian Social Insurance Fund, Obligatory Medical Insurance Fund and Pension Fund have been included into expenditures of the Russian budgetary system.

**Table 1. Distribution of Expenditures
Across the Tiers of the Budgetary System**

Country	Budgetary system expenditures, %		
	Federal level	Regional level	Local level
Germany (1996)	62.1	20.9	17.1
Canada (1995)	40.7	41.6	17.8
USA (1997)	53.5	21.6	24.8
Russia (2001)	55.0	26.5	18.5

Sources: For Germany, USA and Canada assessments were made on the Government Finance Statistics Yearbook, IMF 1999. The figures for Russia were calculated on the basis of the federal, regional and local budget execution reports as of January 1, 2002 (RF Ministry of Finance) and information on extra-budgetary funds.

The share of the subnational governments and social funds amounts to 45% of the expenditures of the Russian general government², which is more than in Germany (38%) but less than in the USA (46%) and Canada (59%).

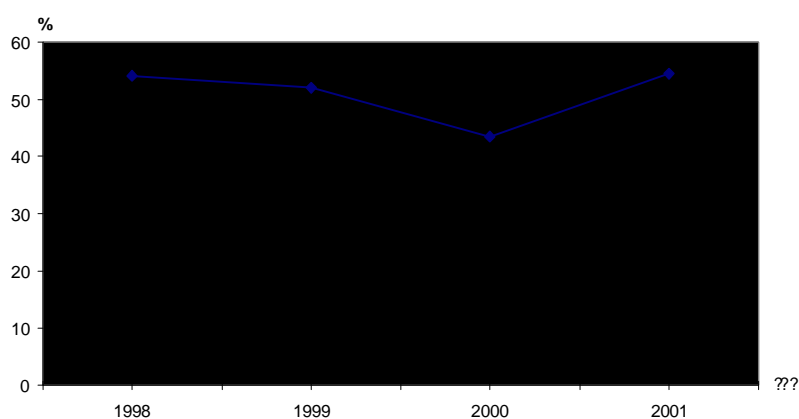
Although the expenditure share of subnational governments is not the perfect measure of fiscal decentralization, it does not need detailed data and is suitable both for comparing

² The general government budget consists of the consolidated budget of the Russian Federation and the budgets of the social extra-budgetary funds (less internal flows).

various countries in terms of decentralization levels and tracking down changes in decentralization over time (Ebel and Yilmaz, 2002).

Changes in the level of decentralization in the Russian Federation can be also assessed on the basis of the Russian consolidated budget data (which does not include extrabudgetary funds). Changes in the subnational share of the Russian consolidated budget's expenditures (Figure 1) demonstrates that the responsibility assignment across the tiers of government is unstable. Between 1998 and 2000, the share of subnational expenditures fell from 54% to 43%, then rose back to its pre-fall level in 2001.

**Figure 1. Subnational Expenditure Share
in the Consolidated Budget of the Russian Federation**



Sources: Authors' calculations based on the federal, regional and local budget execution reports for the relevant years (RF Ministry of Finance).

The share of the subnational governments gives a general idea of the level of expenditures decentralization in Russia. The table below shows the decentralization of spending on individual government functions in Russia.

Table 2. Expenditures on Public Functions in Russia by Tier of Government in 2001, %

Expenditures	Federal budget	Budgets of RF subjects	Local budgets
Federal government functions			
Government (federal tier)	100.0	0.0	0.0
International activity	100.0	0.0	0.0
Defense	100.0	0.0	0.0
Mobilization preparation of economy	100.0	0.0	0.0
Outer space research and use	100.0	0.0	0.0
Military reform	100.0	0.0	0.0

Expenditures	Federal budget	Budgets of RF subjects	Local budgets
Judiciary	93.6	6.3	0.2
Law and order	81.0	14.0	5.0
<i>of which: Militia</i>	<i>57.7</i>	<i>31.2</i>	<i>11.1</i>
<i>Fire protection service</i>	<i>44.4</i>	<i>40.6</i>	<i>15.0</i>
<i>Law-enforcement bodies</i>	<i>96.8</i>	<i>2.9</i>	<i>0.3</i>
Hydrometeorology	92.1	7.5	0.4
Cartography and geodesy	100.0	0.0	0.0
Functions in joint jurisdiction of the federal and regional governments			
Promotion of scientific and technical progress	93.5	6.4	0.1
Prevention and liquidation of aftermath of emergencies and disasters	63.7	26.5	9.8
Education	19.6	21.0	59.3
<i>of which: Pre-school education</i>	<i>1.2</i>	<i>17.6</i>	<i>81.2</i>
<i>General education</i>	<i>0.6</i>	<i>19.7</i>	<i>79.7</i>
<i>Primary education and professional training</i>	<i>58.6</i>	<i>35.8</i>	<i>5.7</i>
<i>Retraining and refresher education</i>	<i>37.1</i>	<i>56.6</i>	<i>6.3</i>
<i>Higher professional education</i>	<i>92.0</i>	<i>6.8</i>	<i>1.2</i>
Health care (including expenditures of obligatory medical insurance funds)	9.6	56.9	33.5
Sanitary and epidemic control	84.3	12.6	3.1
Physical fitness	9.5	46.4	44.1
Culture and arts	18.9	33.2	47.9
Social policy	50.7	30.4	18.9
Housing and utilities	0.0	27.9	72.1
Other expenditures³			
Government (regional tier)	0.0	99.8	0.2
Local self-government	0.0	3.9	96.1
Industry, energy sector and construction	18.6	58.5	22.8
Agriculture and fishery	35.2	51.6	13.2
Mass media	53.8	34.3	11.9
Protection of environment and natural resources (including expenditures of ecological funds)	31.4	56.4	12.2
Cinematography	56.0	18.4	25.6
Transportation ⁴	9.2	56.8	34.0
Road sector (including expenditures of road funds) ⁵	22.9	74.8	2.3
Communication ⁵	13.5	66.5	20.0
Informatics	0.3	67.7	32.0

Sources Authors' calculations based on the federal, regional and local budget execution reports (RF Ministry of Finance) as of January 1, 2002.

³ «Outside of the jurisdiction of the Russian Federation and the power of the Russian Federation on issues within the joint jurisdiction of the Russian Federation and the subjects of the Russian Federation, the subjects of the Russian Federation shall exercise the entire spectrum of state power» (Article 73 of the RF Constitution).

⁴ The federal government is responsible for federal transportation, roads, information and communication while the rest of the functions are in the jurisdiction of the regional governments.

Judging by the data in Table 2 one may conclude that spending on education and health care (together with extra-budgetary funds) is heavily decentralized in Russia. The same applies to expenditures on physical fitness, culture and arts, transportation, road sector, communication, informatics, environment protection and natural resources (together with expenditures of ecological funds). According to budget execution reports, the housing and utilities sector is financed exclusively from the subnational budgets.

When studying decentralization one should remember that the right to spend money does not always mean that governments have the discretion to do as they think fit. If expenditures of lower governments are regulated tightly by laws adopted by higher governments, there will be no real spending independence at the lower tier whatever the decentralization of final expenditures. Besides, the amount of expenditures of lower governments depends on the earmarked grants whose transfer means decentralization of expenditures but may not mean decentralization of responsibilities if spending is under strict control. A considerable portion of non-earmarked funds going to lower governments in form of sharing taxes and equalization transfers also cannot be used discretionally by the governments that make the actual spending. First, very often a higher government wants such funds to be spent on a specific item (wages regulated in accordance with the Uniform Wage Scale⁵). Second, the subnational governments in Russia are under tight legislative regulation regarding practically all kinds of public expenditures. In spite of the fact that their discretion in spending non-earmarked funds is restricted, such spending is recognized as non-earmarked in budget reports. Therefore, when measuring the degree of decentralization it is important to view responsibilities of the subnational governments in greater detail not confining oneself to quantitative indicators.

The share of subnational spending is often used as a measure of decentralization (e.g., see Davoodi and Zou, 1998). However, one should remember that this is a measure of service delivery which says nothing about regulatory or financing decentralization.

⁵ The Ministry of Labor is preparing a law to reform the wages system for public employees. According to this proposal, the Uniform Wage Scale will be substituted with up to 30 branch wage systems for public employees. However, should their salaries be determined at the federal level, subnational governments will not become more independent in their decisions.

Qualitative Measurement of Expenditure Decentralization

With a clear assignment of functional responsibilities among the government tiers all three types of responsibilities, namely legislative, financial and executive, are assigned to a certain tier of government. In this case no overlapping of responsibilities takes place. The federal (central) government does not interfere with the way the regions carry out their regional functions while the regions have no say in local functions.

It should be noted that the degree of expenditure decentralization cannot be estimated on the basis of responsibilities assignment alone. For instance, if school education is assigned to the regional governments and all the other functions are assigned to the federal level, with the amount of spending on school education being the same as for the rest of the functions, then the degree of government functions decentralization, measured by the share of subnational spending in the consolidated budget, may be very high though less functions are assigned to the regional level than to the federal one.

On the other hand, if all public functions are regulated and financed by the federal center and subnational governments are to comply with the higher decisions using conditional federal transfers, the share of subnational expenditures, though rather significant, will not mean a high degree of decentralization.

The higher the centralization of legislative regulation as compared with the execution of functions, the lesser the share of subnational expenditures in total government spending will represent true decentralization of power.

Theoretically, the level of expenditure decentralization can be estimated by analyzing Russian laws pertaining to power assignment across the governments of different levels. However, Russian legislation is contradictory to such an extent that it is difficult to determine the government of which level is responsible for which function, since the responsibilities are assigned using the ownership criteria rather than the functional principle.⁶ Presented below is a review of laws regulating the responsibilities assignment in the field of education (Table 3).

⁶ For instance, if a kindergarten is the property of the regional administration, then this kindergarten is operated and financed by the regional government irrespective of the current assignment of functions or services.

**Table 3. Education: Responsibilities Assignment
Across Tiers of Government in the Russian Federation**

Education	Regulation	Financing	Provision
Preschool education	F+R	F, R, L	L
Basic secondary education	F+R	F, R, L	L
Full secondary education	F+R	F, R, L	?
Primary and secondary professional education	F+R	F, R, L	?
Higher education	F+R	F, R, L	?
Graduate professional education	F+R	F, R, L	?

Symbols:

Level of government (budget): F – federal, R – regional, L – local;

? – no assignment of responsibilities;

+ – joint responsibility: minimum standards are set by the federal government, additional standards are set by regional or municipal governments.

Source: CFP's legislation review.⁷

Even a brief survey of Table 3 shows that it would be wrong to judge the level of decentralization only by the share of expenditures of each level of government in total spending on a function (Table 2). Thus, according to the data in Table 2, 8% of spending on education comes from the subnational budgets. Earlier we saw that the federal center participates in regulating all aspects of education and that it can be involved in financing practically all types of education (e.g., by funding schools owned by federal ministries and agencies). Consequently, the federal center plays a more significant role in rendering education services in Russia than is evidenced by the share of expenditures on education covered from the federal budget.

Being unable to evaluate the degree of decentralization on the basis of current legislation owing to a lack of clear responsibilities assignment, we nevertheless can use the pertaining provisions of the *Program for Fiscal Federalism Development in the Russian Federation up to 2005* that offers a general scheme of major expenditure responsibilities division among the tiers of government in Russia (hereinafter: General Scheme). An extract from the General Scheme is given in Table 4.

It should be remembered that the following extract is but a desired (planned) arrangement and the difference between it and the current assignment is that the former envisages a lesser number of joint responsibilities for services financing, weaker federal control over public expenditures funded from the subnational budgets and some other features amounting to clearer assignment of power and responsibilities across the tiers of government.

⁷ www.fpcenter.org

Table 4. Assignment of Responsibilities in the Field of Education as Proposed by the Program for Fiscal Federalism Development in the Russian Federation up to 2005

Function	Regulation	Financing	Provision
Education			
Preschool education	L	L+P	L
Secondary (school) education (system support)	F+R+L	L	L
Secondary education (development programs)	F	F+R	R+L
Boarding schools	F+R	R	R
Primary and secondary professional education	F+R	F+R	R
Primary and secondary professional education for the handicapped	F+R	F+R	F+R
Retraining and refresher courses	F+R	F+R	F+R
Higher education	F+R	F+R+P	F+R

Symbols:

Level of government (budget): F – federal, R – regional, L – local;

P – funds provided by population;

+ - joint responsibility (co-financing).

Altogether, the total number of functions and the number of responsibilities assigned to specific tiers of government as envisaged in the General Scheme is as follows:

Functions, total number:	119
<i>of which assigned to:</i>	
federal level only	55
regional level only	9
local level only	12
Functions that do not overlap, total	76
Overlapping functions, total	43

The above data are aggregated in Table 5.

Table 5. Functions Assignment among Tiers of Government as Proposed by the Program for Fiscal Federalism Development in the Russian Federation up to 2005

	Regulation	Financing	Provision
Functions envisaged in the General Scheme, total	119	119	119
References to the tier of government in each column, total	F=97 R=40 L=27	F=76 R=43 L=28	F=70 R=42 L=31

	Regulation	Financing	Provision
Total weight of each level of government in executing each type of responsibility (in case of a joint responsibility, weight is shared equally between the tiers in the following proportion: 0.5+0.5 or 0.33+0.33+0.33) as compared with the real number of functions	F=77,5 R=23,5 L=18	F=65,33 R=30,83 L=22,83	F=63 R=32 L=25
The same expressed as percentage (119=100%)	F=73 R=12 L=14	F=55 R=26 L=19	F=53 R=27 L=20

Out of 119 functions referred to in the General Scheme, the federal government controls 97. It means that only 22 functions may be regulated (through setting rules and standards) by the subnational governments (e.g., regional and local mass media support, maintenance of regional and local property, activities of regional and local significance, functioning of subnational governments). At the same time the federal government provides financing to a fewer number of functions as compared with the number of those under its legislative control (76 vs. 97), and is involved in delivery of a fewer functions than the number of functions it legislates (70 vs. 97; see Tab. 5). As far as subnational governments are concerned, quite the opposite takes place: they have little say in legislation matters but are becoming more active in terms of financing or service rendering. However, it is the federal government that plays the predominant role at all stages.

To summarize the above: the comparison of the degree of decentralization regarding legislative regulation, financing and delivering public services (Table 5) shows that according to the General Scheme the responsibilities for legislative regulation are concentrated at the federal level.

The Problem of Mandated Expenditures

The analysis of the present responsibilities assignment across the tiers of government in the Russian Federation indicates that the arrangement is not clear enough and that the actual practice of execution of functions does not correspond to the pattern envisaged by the RF Constitution and current legislation. A great number of federal laws regulating delivery of the functions assigned to the regional and local governments may be a sign of centralization. However, if there are too many of such laws and they cannot be properly funded, the subnational governments begin choosing which of them they would implement thus turning the excessive regulation into its opposite.

In the Russian Federation, quite a lot of subnational expenditures are controlled by federal legislation. One can name the obligatory wage level for staff of budget-supported institutions or the federal mandates pertaining to allowances for certain population groups. It is estimated that about 30%⁸ of subnational expenditures are those on federal mandates, i.e. federal laws and regulations that induce greater spending on the part of the regional and local governments.

Facts Testifying to Decentralization of Expenditure Responsibilities

Despite a considerable share of federal mandates in the subnational budgets one may maintain that in Russia decisions on public spending are taken in a decentralized manner. Indirectly, this is testified by the differences in expenditure structure across the RF subjects (Table 6).

Table 6. Differences in the Regional Expenditure Structure: Shares of Regional Consolidated Budgets Allocated for the Main Public Functions (2001)

Line item in Budget Classification	Share of expenditures per public function in total budget expenditures		
	median	maximum	minimum
Government and local self-government	6.9	14.1	1.9
Law enforcement and national security	2.9	5.7	1.0
Industry, energy and construction	7.1	34.8	2.4
Agriculture and fishery	3.2	14.3	0.1
Transportation, road sector, communication and informatics	3.4	10.7	0.2
Housing and utilities	14.9	27.3	2.1
Education	20.9	32.1	7.6
Culture, arts and cinematography	2.3	3.8	0.9
Health care and physical culture	13.6	26.3	7.2
Social policy	9.4	15.5	2.9

Source: Authors' calculations based on the regional and local budget execution reports (RF Ministry of Finance). as of January 1, 2002 (RF Ministry of Finance)

The regional governments spend from 8% to 32% on education while the share of Social Policy line item varies from 3% to 16%. The regions differ considerably (dozens of times) in the share of economy support expenditures (Industry, Energy and Construction;

⁸ The CFP's estimation is based on the assignment of subnational expenditures by the Budget Classification line items (in accordance with the budget execution reports of the RF subjects and municipalities as of January 1, 2002). For this purpose,

Agriculture and Fishery) though in this case the reason may have more to do with politics than with differences in economic profile of regions. Besides, one should remember that the current Budget Classification is not very clear and the same expenditures can be reported as different line items by finance departments of different regions. Still, budget execution reports demonstrate a range of regional priorities in financing government functions and, consequently, decentralization of expenditure responsibilities.

Decentralization of Revenues

Decentralization of revenue mobilization responsibilities does not necessarily accompany decentralization of expenditure responsibilities. Everywhere in the world expenditures are more heavily decentralized than revenues (Ebel and Yilmaz, 2002) which is explained by objective reasons. Expenditure decentralization makes it possible to differentiate service provision to suit local preferences, which is especially important for a vast country like Russia. At the same time differentiation of tax burden gives rise to transfer pricing, tax competition among jurisdictions and other negative phenomena. Centralization of taxing powers deprives tax avoidance of any sense. Here by tax avoidance we mean cases when companies are registered in jurisdictions with lower tax incidence while operating outside of those jurisdictions. It also makes tax collection simpler and more cost-effective. Transition economies are characterized by decentralized expenditure responsibilities and insignificant decentralization of revenue sources (Bahl, 1999). However, a noticeable weakness of a system with decentralized expenditure responsibilities and centralized taxing powers is the disrupted connection between tax burden and public service rendering.

Quantitative Measurement of Revenue Decentralization

To measure revenue decentralization one may use the share of subnational proceeds (before transfers) in the revenues of the consolidated budget. As has already been mentioned, extrabudgetary funds are not included into the consolidated budget of the Russian Federation. In order to compare Russia with other countries (Table 7) we added the proceeds of the Social Insurance Fund, the Fund of Compulsory Medical Insurance and the Pension Fund to the consolidated budget figures.

transfers to the population, part of expenditures on social policy, housing and utilities subsidies and salaries of staff at budget-supported institutions were taken into account.

**Table 7. Distribution of Revenues (before Transfers)
Across the Tiers of the Budgetary System**

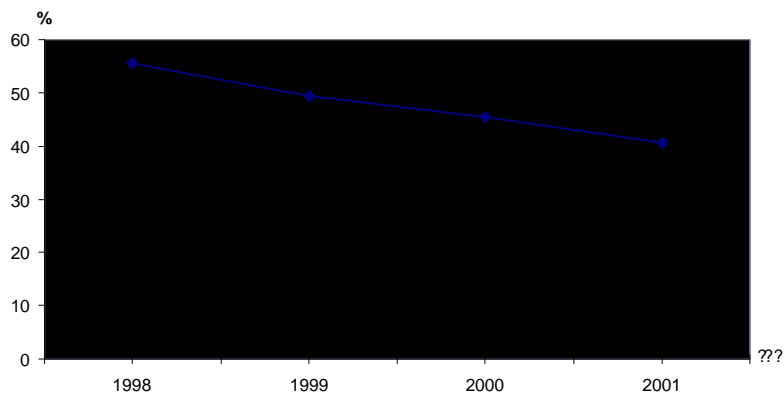
Country	Budgetary system revenues, %		
	Federal level	Regional level	Local level
Germany (1996)	66.1	21.3	12.6
Canada (1995)	45.1	43.5	11.4
USA (1997)	58.4	25.9	15.7
Russia (2001)	63.7	24.0	12.3

Sources: For Germany, USA and Canada assessments were made on the basis of the Government Finance Statistics Yearbook, IMF 1999. The figures for Russia were calculated on the basis of the federal, regional and local budget execution reports as of January 1, 2002 (RF Ministry of Finance) and information on the budgets of the extra-budgetary funds.

The revenue share of the subnational budgets and extra-budgetary funds in the Russian Federation general government budget⁹ is 36%, which is more than in Germany (34%) but less than in the USA (42%) and Canada (55%).

Changes in the share of subnational revenues in the RF consolidated budget (without revenues of the extra-budgetary funds) over time demonstrate a downward trend (Figure 2), which is an evidence of growing revenue centralization.

**Figure 2. Subnational Revenue Share
in the Consolidated Budget of the Russian Federation**



Source: Authors' calculations based on the federal, regional and local budget execution reports for the relevant years (RF Ministry of Finance)

⁹ The general government budget consists of the consolidated budget of the Russian Federation and the budgets of the social extra-budgetary funds (less internal flows). For the purpose of the Russian revenue structure assessment in Table 7 shared taxes were viewed as tax revenues rather than transfers from higher budgets.

Qualitative Measurement of Revenue Decentralization

The share of subnational revenues does not reflect the degree of real fiscal autonomy of the RF subjects. Judging by the total amount of tax revenues it is impossible to learn what portion of them is under control of the subnational governments (e.g., where they may change tax rates) and what portion consists of shared taxes. Table 8 provides information on the main Russian taxes. According to it, the greater part of tax revenues is regulated by the federal center. Even when the subnational governments can change a tax rate, proceeds from such tax are split among the tiers of government in proportion established by the federal government. Such distribution of taxing power is a sign of a highly centralized tax system.

Table 8. Main Taxes and Fees in the Russian Federation

Tier of government that	Taxes on income and profits			Taxes on property			Taxes on consumption			Other taxes and fees				
	Profits tax	Single tax on imputed income	Personal income tax	Property of physical persons	Enterprises Property tax	Inheritance and gift tax	Sales tax	VAT	Excise taxes	Gambling tax	License and registration fees	Land tax	Payments for using forest resources, water bodies; payments for standard and excessive emissions of hazardous substances	Other payments for natural resources use
Imposes tax	F	R	F	F	F	F	F	F	F	F	F	F	F	F
Determines tax base	F	F,R	F	F	F	F	F	F	F	F	F	F	F	F
Sets tax rate	F, R(F), L(F)	F,R	F	L(F)	R(F)	F	R(L)	F	F	F,R	F	L(F)	F, R(F)	F
Gets proceeds	F, R, L	F, R	F,R	L	R,L	L	R,L	F	F,R	F,R	F, R, L	F, R, L	F,R	F
Principle underlying revenue split among tiers of government	2	1	1		1	1	1		1	2		1	1	1

*Symbols: F – federal level, R – regional level, L – local level,
(F) – regional or local governments set tax rate within the federal limits
The principle underlying revenue split among the tiers of government:
1 - as % of shared tax; 2 –according to piggybacking rate*

Thus, the subnational share of revenue cannot be called a very reliable indicator of decentralization as the subnational governments in Russia have no important impact on proceeds from most tax sources.

Tax Autonomy of Subnational Levels of Government

In order to assess the degree of tax autonomy of the subnational governments one can use the classification of taxing powers developed by OECD (1999). According to it taxes are

subdivided into the following categories ranked by decreasing order of control that the subnational levels of government can exercise over the revenue source:

- a) subnational levels of government set tax rate and tax base;
- b) subnational levels of government set tax rate only;
- c) subnational levels of government set tax base only;
- d) tax sharing arrangements:
 - d.1) subnational levels of government determine revenue split;
 - d.2) revenue split can only be changed with consent of subnational levels of government;
 - d.3) revenue split fixed in legislation, may unilaterally be changed by central government;
 - d.4) revenue split determined by central government as part of the annual budget process;
- e) central government sets tax rate and tax base.

In cases (a)-(c) and (d.1)-(d.2) the subnational levels of government have significant control over tax revenues. In the remaining cases their tax autonomy is limited or non-existent.

It was rather difficult to assess tax autonomy of the subnational governments regarding the tax sources assigned to the RF subjects and local governments in accordance with the above OECD classification (Table 9). Thus, there are federal limits on maximum rates with regard to some taxes whose base or rate are set by the subnational governments. Nevertheless, we refer such taxes to category (a) (Single tax on imputed income, for example) or category (b). It is difficult to determine the category of taxes that fall into the federal group under legislation but whose rate is set by the regional governments within the federal limits (Charges on users of water resources). We referred them to category (b) though this somewhat deviates from the OECD categories. However, the error cannot distort the degree of regional tax autonomy because the share of these taxes in subnational revenues is not large. The land tax also presented some complications for the following reasons: being a local tax its rates are set by the local governments taking into account average values determined by federal legislation; at the same time land tax revenues are apportioned across tiers of government according to the federal budget law. Therefore, proceeds from the land tax for the RF subjects were referred to category (d.3) and for the local governments to category (b).

Table 9. Taxes of Subnational Government by Type of Tax Autonomy*

Subnational government taxes as a percent of total tax revenues		Subnational government tax revenues arranged by type of tax autonomy							
		a	b	c	d.1	d.2	d.3	d.4	e
Austria (1995)	19								
Local governments	8	9	11			81			
Lands	10	2				98			
Germany (1995)	29								
Local governments	7	1	52			47			
Lands	22					100			
Spain (1995)	13								
Local governments	9	33	51			16			
Regions	5	15	7			78			
Mexico (1995)	20								
Local governments	4						74		26
States	16	14				86			
Switzerland (1995)	38								
Communities	16		97				3		
Cantons	22	89				6	5		
Russian Federation (2001)**	41								
Local governments	5		25				15	59	1
RF subjects (regions)	36	3	35				21	41	0

Source: *OECD Tax Policy Studies, Taxing Powers of State and Local Government, 1999*; data for the Russian Federation are calculated on the basis of the regional and local budget execution reports as January 1, 2002.

* Tax autonomy categories:

- a) subnational governments set tax rate and tax base;
- b) subnational governments set tax rate;
- c) subnational governments set tax base only;
- d) tax sharing arrangements:
 - d.1) subnational governments determine revenue split;
 - d.2.) revenue split can only be changed with consent of subnational governments;
 - d.3) revenue split fixed in legislation, may unilaterally be changed by central government;
 - d.4) revenue split determined by central government as part of the annual budget process;
- e) central government sets tax rate and base.

** These are the data on revenues before allocation of shared taxes to the local (municipal) governments. Because in the cities of Moscow and Saint-Petersburg the system of tax assignment to the tiers of government differs from the rest of the RF subjects, the data on the regional consolidated budgets do not include Moscow and Saint-Petersburg to avoid distortions in the revenue structure.

Though all tax decisions of the federal government are enacted after approval of the Federation Council, in other words all amendments in tax revenue allocation to the tiers of government are agreed formally with the RF subjects, the Federation Council has no practical influence on the tax policy of the federal center. This is the reason why there is no tax falling into category (d.2).

It is evident from Table 9 that the subnational levels of government in the Russian Federation, though receiving more tax revenues than is the case in other federations, are considerably less autonomous.

Thus, in tax revenues of a RF region 41% come from taxes that are shared in accordance with the budget law. Consequently, when planning their next year budgets the regions cannot be sure that the sources that brought them 41% of revenue will be available in the next fiscal year. The taxes shared among the tiers of government by federal legislation provide 21% of tax revenues to the regional budgets. In this case, one also cannot be sure that the federal center would not amend tax laws to change the apportionment of shares. Even those taxes whose rates are set by the regions and that constitute a considerable portion of regional tax proceeds (35% of regional tax proceeds) cannot ensure stable tax revenue of the subnational budgets since some of them are also allocated between the tiers of government in accordance with federal legislation.

It is possible to assess the degree of autonomy of the subnational governments by looking at the share of subnational “own source” revenues in the total revenues of the relevant budgets: the higher the share of “own source” subnational revenues, the greater the level of decentralization.

Table 10. The Revenue Structure of Consolidated¹⁰ Budgets of RF Subjects in 2001

Revenue category	Share in consolidated budgets of RF subjects, %
“Own-source” revenues	45
<i>“Own-source” tax revenues*</i>	38
<i>Non-tax revenues</i>	7
Other revenues	50
<i>Shared taxes**</i>	39
<i>General purpose transfers</i>	11
Earmarked transfers	5
<i>subventions</i>	5
Total	100

* These are the taxes of categories a-c in Table 9.

** These are the taxes of categories d-e in Table 9.

Source: Authors’ calculations based on the regional and local budget execution reports in the Russian Federation as of January 1, 2002.

As can be seen from the general structure of revenues in Table 10, subnational governments rely heavily on financing from the federal budget. Their “own-source” revenues amount to 45% in the consolidated budgets of the RF subjects, which means that more than

¹⁰ Consolidated Budgets of RF Subjects means regional and local budgets

half of their revenues comes from transfers and shared taxes. Such a strong dependence of subnational revenues on the federal center indicates a low level of revenue decentralization.

Another problem in connection with decentralization assessment is that of aggregation. Revenue raising possibilities of different regions being considerably different, the following can take place: while in terms of the consolidated budget the governments may have great financial autonomy, each of the regional budgets (with the exception of a few) viewed separately will demonstrate an insignificant share of own revenues.

Decentralization of the Borrowing Power

Borrowing power of regional and local governments can also be an indicator of financial autonomy of subnational budgets. Provided the governments pursue a prudent policy on the capital market, their autonomy will grow when the subnational budgets receive the right to make direct and indirect borrowings.

In Russia, the federal and local governments may issue securities and attract funds of credit organizations. As is evident from the budget execution reports, some regions and municipalities are quite active in this respect.

Thus, over 10% of the budget expenditures of Ust-Orda Buryat AO and over 15% of Tomsk Oblast expenditures were financed by government securities issues in 2000. In the same year the amounts of borrowed funds were approximately equal to those spent on repayment of the principal debt by Altai Krai and Voronezh and Volgograd Oblasts.

Municipalities also issue their securities, though in lesser volumes than regional governments. In comparison with the latter, credits are a far more frequently used instrument. Evenk AO, for instance, covered over 20% of its 2000 expenditures by credits.

Another form of decentralization that is typical of Russia is outstanding liabilities. Subnational governments adopt budgets about which it is known in advance that they will never be executed as adopted. At the execution stage, the governments exercise their autonomy by deciding which line items they will finance in full and which will remain underfinanced. For example, regions can finance own expenditures in full and spend less money than is necessary on federal mandates. Therefore, outstanding liabilities can be considered as a form of enforced borrowing from spending agencies.

According to budget execution reports, as of January 1, 2001, in six RF subjects outstanding liabilities of the consolidated budgets amounted to over 10% of their expenditures

(10.7% in Kursk Oblast, 11.2% in Omsk Oblast, 15.0% in Ulianovsk Oblast, 16.7% in Tambov Oblast, 18.6% in Altai Krai and 18.8% in the Republic of Mari El).

Conclusions

In the absence of a single, generally used method to measure the degree of decentralization, different approaches can bring different results (Ebel and Yilmaz, 2001). Transition economies are particularly vulnerable in this regard. A high degree of data aggregation can also result in overestimation of decentralization.

The most common indicators used for estimating the degree of decentralization are the shares of subnational expenditures and revenues in expenditures and revenues of the national budgetary system. In the Russian Federation, these indicators demonstrate a considerable decentralization of expenditure and revenue responsibilities. However, being aggregated, these indicators do not reflect either the discretion of the subnational governments in choosing their spending policy (the share of own expenditures in total subnational spending) or the degree of their fiscal autonomy. In view of the fact that unconditional expenditures amount to about 70% while “own-source” revenues constitute only 45% of all subnational revenues one may conclude that expenditures in the Russian Federation are much more decentralized than revenues, which is quite common for economies in transition.

The qualitative analysis shows that the legislative framework for most public functions is established by the federal center. Therefore, the role of the federal government in public service provision is more important than it may seem. This is proved by the share of final expenditures funded from the federal budget. The federal center has a great impact on the tax system as well as it determines the rates and bases of most taxes. Besides, a considerable portion of subnational revenues (39%) are those from the shared taxes that are split at the federal government’s discretion. Evidently, the degree of decentralization in the Russian Federation is much lower than one may assume judging by the subnational shares of revenues and expenditures in the consolidated budget of the federal government.

Presently, an inventory of expenditure and revenue responsibilities of all tiers of government is being taken. Hopefully, as a result of the reforms Russia may become a truly federative state where the subnational governments will possess a significant amount of power to render public services as well as own revenues that will be enough to fund these functions.

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