

Fiscal resilience of Russia's regions in the face of COVID-19

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Abstract

Purpose – The purpose of the study was to analyze how COVID-19 pandemic affects regional budgets and regional fiscal resilience in Russia.

Design/methodology/approach – The research article is structured as follows. Based on the official data from the Ministry of Finance, the Federal Treasury and the Accounts Chamber of the Russian Federation, first, the state of Russian regional budgets before and under COVID-19 is analyzed. Second, due to the increase of regional spending commitments under pandemic the regional debt dependence is reviewed. Third, anticrisis fiscal measures which have been taken to combat the negative impact of COVID-19 are discussed.

Findings – In general, 2020 may be the most difficult for regional budgets, although the results of the first quarter do not show such tension. However, the impact of COVID-19 on budget indicators is ambiguous because the economic crisis of 2020 is dual, including the crisis in the oil markets. The pandemic has become a unique global phenomenon, the effect of which is difficult to identify and interpret outside of the economic aspects of life.

Originality/value – The value of the article is based on the overview of the state of regional budgets before and under COVID-19, on the analysis of how pandemic affects fiscal resilience of the regional budgets and on the forecast of how serious the volume of lost revenues are going to be.

Keywords Regions of Russia, Regional budgets, Fiscal resilience, Pandemic, COVID-19

Paper type Viewpoint

Introduction

A crisis always affects budget systems at various levels. The fiscal impact of disasters on a government's budget can be sizeable (OECD-World Bank, 2019). At the same time, many countries have significant financing constraints (Darvas, 2010). The budgets of those territories that do not have the opportunity for budget maneuvers are especially affected. In a crisis, the horizon of fiscal planning is shrinking. Under COVID-19 and the uncertainty in the global energy market, regions have been forced to switch to budgeting within a few months so as to adapt the measures taken in a timely manner to support the economy and the population.

Issues of fiscal federalism in Russia are being actively developed by several domestic scientists (Lavrov, 2019; Deryugin, 2016; Libman, 2011). Some of these scientists consider how public finances behave during a crisis (Akindinova *et al.*, 2016; Alexeev and Chernyavskiy, 2018; Drobyshevsky and Sinelnikov-Murylev, 2012; Vlasov *et al.*, 2013).

One of the criteria for sustainable development is resilience – a measure of vulnerability (in the short term) in relation to the impact of crises of various kinds, including economic, social and environmental (Fassi and Sadini, 2018). Following the concept of resilience, fiscal resilience at the regional level is the ability of the regional budget system to recover from



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The article presents some results of the project “Theoretical foundations of regional fiscal sustainability and its application in the public administration”, carried out within the scope of RANEPА financial support for 2020.

various shocks that either throw it off the path of balanced development or have the potential to do so.

The research on Russia shows that, in general, the more developed regions are more resilient (Klimanov *et al.*, 2020). So, the state of regional budget revenues during the crisis will be affected by the fact that in Russia the regional budgets are highly depend on federal transfers.

Regional budgets before and during COVID-19

The regional budgets [1] in Russia had a positive trend prior to the 2020 crisis. In general, revenues grew faster than expenditures. The total amount of the initially planned revenues of regional budgets for 2020 [2] amounted to 12.1 tn rubles (about 11% of GDP) and expenditures – 13.0 tn rubles (12% of GDP).

In Russia, ten of the total 85 regions make up almost half of the total revenues and expenses of subnational budgets. The budget of federal city of Moscow for 2020 FY is equal to 23 and 24% of total regional revenues and expenses. Federal city of St. Petersburg lags Moscow by more than four times in terms of absolute fiscal indicators and the Moscow Region by 4.5 times. In total, six more regions planned spending at less than ten percent of the levels in Moscow.

In spring of 2020, the regions were faced with the need to reorient their budget spending to increase fiscal resilience and recover their economies. Since April, the rate of revenue growth has fallen sharply compared to the same period for 2019 from 60 to 43%. This fall was partially compensated by federal grants, while expenditures, on the contrary, showed an increase from 48 to 52%. In addition, income declined much faster than expenses grew. The collection of regional tax and nontax revenues in the regional budgets has decreased even more. In May, the situation improved; budget revenues grew at a faster pace than in 2019, while expenditures remained at the 2019 level. Thus, it can be assumed that the peak of the negative impact of the pandemic on regional budgets was reached in April, and further governmental measures helped to restore the situation.

The decrease in regional revenues of the consolidated regional budgets during April–June was primarily due to the lowering of corporate income tax and personal income tax, which totaled 80% of all tax and non-tax revenues of regional budgets during January–June 2020.

Despite falling revenues and rising expenditures, some regions were able to achieve a surplus in their consolidated budgets. However, compared to 2019, the results are not as impressive. As of July 1, 2020, the expenditures of the regions were adjusted and increased by 6.5% compared with the initially approved indicators at the beginning of FY. The planned deficit values also have increased twice. According to the data, the consolidated budgets were implemented with a deficit of 219.6 bn rubles.

Compared to the corresponding period in 2019, revenues increased by 2.1%. There is a decrease in tax and nontax revenues by 8.9% compared to the same period in 2019. At the same time, during the first quarter the growth of tax and nontax revenues of regional budgets was eight percent compared to the first quarter of 2019.

During the second quarter of 2020 (April–June) and the ensuing three months of implementing measures related to preventing the impact of the crisis on the economy and the prevention and elimination of the consequences of the spread of coronavirus infection, the volume of tax and nontax revenues of the consolidated budgets decreased by 33.2% compared to the same period in 2019.

On the other hand, spending increased by 19.0%. The growth of expenditures is observed in 83 regions; in 24 of those regions they increased by more than 20%.

As a result of the spread of the novel coronavirus infection and the deterioration of the economic situation, the volume of lost revenues of consolidated budgets will eventually

amount to more than 2.0 tn rubles in 2020, while Moscow alone accounts for 701.0 bn rubles [3].

In Russia, regional budgets remain highly dependent on federal grants. Regions received the amount of 2,450 bn rubles or 2.2% of GDP as grants in 2019. The share of federal grants in total revenues of regional budgets ranges from 1 (Moscow City) to 88% (Republic of Ingushetia).

Currently, in the Russian Federation there are three main types of intergovernmental fiscal transfers: subsidies, subventions and unconditional grants (dotations). Subsidies are provided to regions for regional and joint expenditure commitments and imply cofinancing. Subventions are provided for the implementation of expenditure commitments of the Federation.

Since 1994, a maximum of 20 regions have not received unconditional grants from the federal budget. The others have applied and received such grants, earning them the title of recipient region. In several subsidized regions, the share of gratuitous receipts in consolidated budget revenues has consistently exceeded 60%. In addition, the federal budget provides the regional budgets with about 100 types of targeted subsidies. Usually during a crisis, the number of types of subsidies from the federal budget increases (Mikhaylova *et al.*, 2019).

The crisis of 2020 showed that during shock situations the short-term stability or resilience of regional budgets is provided by federal support. Rich regions, whose income directly depends on the economic activity, were the most affected from the crisis of 2020. Federal grants were able to soften the blow to regional budgets and partially offset the fall in regional revenues.

In total, in 2020, it is planned that the federal government will provide 2.1 tn rubles of federal grants, including one trillion rubles of unconditional grants [4]. According to the data from the Federal Treasury, for July 1, 2020, regional budgets have received from federal grants amounting to 1376.8 bn rubles, which is 57.4% higher than the same period in 2019 and nearly 50% of which are unconditional grants.

The largest share of regional expenditures falls on education (as of June 1, 2020, 26.3%), social policy (22.8%), the national economy (15.9%) and housing and utilities (8.1%). However, there has been an increase in spending on health, environmental protection, national economy and security compared to the same period in 2019, while all other areas have been declining.

The structure of regional budgets' expenditures is dominated by such areas as social policy (about 21% of total expenditures), education (21%) and the national economy (21%). On average, about ten percent of expenditures (between 6 and 18%) are allocated to health care by the regions. Planned spending on housing and utilities averages eight percent but this varies widely across regions, from 1 to 24%.

Most of the Russian regions began 2020 with a legislatively approved budget deficit. The total deficit of 59 regions initially amounted to 860.6 bn rubles, including 351.3 bn rubles (almost 41% of the total) being the deficit of Moscow.

The first adjustments to the regional budgets were made at the beginning of FY 2020. For the first quarter of 2020, planned budget expenditures were increased in 56 regions of Russia, and revenues were also revised upward.

This adjustment of laws on regional budgets was caused by a number of reasons, including the adaptation of the provisions of the Annual Presidential Address to the Federal Assembly (Parliament) of January 15, which outlined numerous actions requiring additional expenses of the federal and regional budgets. Almost all these expenses are directed to the development of such areas as healthcare, education, social policy and housing. It should be noted that upward changes in expenses were also made in the federal budget [5].

Thus, prior to the onset of the economic crisis of 2020, regional governments in relation to their budgets demonstrated counter-cyclical behavior. Analysis of changes in revenues and

expenditures of regional budgets showed that for the first quarter of 2020, planned expenses for the current fiscal year changed more (2.6%) than planned revenues (1.5%). In the next months, regional fiscal policy has been changed. The Ministry of Finance of Russia directly recommended the regions to reduce costs and restrain their growth due to higher wages to state employees.

In general, for the first quarter of 2020, the regions “dispersed” their planned expenses quite strongly, exceeding the planned level of the previous year, first due to the implementation of measures from the Presidential Address. At the same time, the increase in expenses had not been accompanied by commensurate increase in revenues. The situation changed under COVID-19.

Assessing the changes in the status of subnational budgets in Russia in the early autumn of 2020, we can see the regions were largely more resilient in general than predicted at the advent of the crisis caused by the pandemic. This was mostly due to a significant increase in federal grants in the context of low fiscal independence of the regions.

Debt dependence of regions

In the face of declining revenues and increasing expenditures to fund anticoronavirus measures, further increase in regional budget deficits and debt burden during 2020 is expected.

The annual dynamics of regional public debt demonstrates steady decline from 2016 till the first quarter of 2020 (Figure 1). However, the volume of regional debt remained relatively high, amounting to more than 2 tn rubles or 1.9% of GDP as of April 1, 2020 and increased during April–May to 2.1 tn rubles.

Among regions, two (Sakhalin and Sevastopol) do not have public debt at all. In total, 12 regions keep their debt at less than five billion rubles, which differs from the debt of 50–100 bn carried by nine regions. The maximum debt level is in the Moscow Region (168 bn rubles), but it does not cause concern, since this is only about a quarter of its own tax and nontax

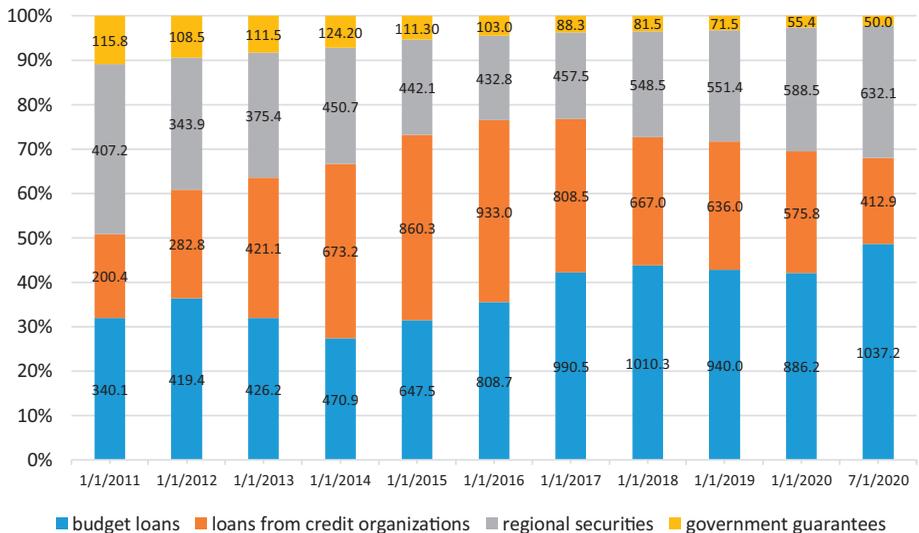


Figure 1. Public debt of Russia's regions in 2010–2020, billion rubles

Authors' calculations according to the Federal Treasury

revenues. Furthermore, it is highly likely that the region will be able to pay its financial obligations in time and in full. However, the concept of fiscal resilience is being poorly applied in the cases of the Republic of Mordovia, where the ratio of public debt to local income at the end of 2019 amounted to 174%, Republic of Khakassia (78%), Pskov Region (73%) and Smolensk Region (71%).

In connection with the new anticrisis commitments, which are more social and require a proactive economic policy, these regions will need even more federal support for the timely financial support of anticrisis activities.

According to the results of the first half of 2020, 78 regions have budget loans from the federal government. The share of budget loans exceeds 50% in total debt in 43 of those regions. This represents an increase of 107 bn rubles in the first quarter of 2020 and by 20 bn rubles over the following two months, amounting to a total loan indebtedness of 1,037 bn rubles by July 1, 2020.

Given the changes in budget legislation adopted in April 2020, we expect that the volumes and the structure of public debt in regional budgets will change upward. There should also be a substantial revision of the role of budget loans as a factor for maintaining stable regional situations.

Anticrisis fiscal measures

The crisis of 2020 has been characterized by a sharp decrease in tax revenues of regional budgets due to the significant reduction in the amount of income from personal income tax and corporate income tax. At the same time, the decline in tax revenues will be regionally differentiated: highly subsidized regions will suffer the least, since the share in their revenues is small, while the consequences of the crisis will be more painful for the regions with the largest concentration of agglomerations, regions with developed services as well as regions with the highest share of personal income tax in budget revenues and the regions those are most reliant on oil and gas production (Zubarevich, 2020).

A number of experts (Milchakov, 2020) have concluded that if additional measures to support the regions are not taken during the crisis, the decrease in tax and nontax revenues of the consolidated budgets of the regions in 2020 compared with 2019 may reach from 5.3 to 13.3% in various scenarios. About 1/3 of the lost tax and nontax revenues may fall upon the cities of Moscow and St.Petersburg.

In conditions of the rapid growth in new obligations to support people and businesses, the regions will not have the opportunity to pay off their debt obligations this year. It is assumed that the maximum values of public debt will be recorded in the last quarter of the year. Thus, if commensurate federal support is not provided to the regions, the volume of public debt by the end of 2020 in relation to 2019 will most likely increase. The largest growth will be observed in the volume of budget loans from the Federal budget.

Government anticrisis fiscal measures in 2020 which are related to the amendments to the Budget Code include the following [6]. The budget deficit of Russia's regions may exceed the established limits by the amount of spending aimed to prevent the impact of a deteriorating economic situation and respond to the consequences of COVID-19. The amount of regional debt may also exceed the established limits. During the execution of the FY 2020 budgets, governments have the right to make decisions on the provision of state guarantees more than its total established amount. Repayment of budget loans granted earlier from the Federal budget to regions has been prolonged till 2034. The released funds will be used for financial support of anticrisis measures in 2020. Russia's regions can provide budget loans to other regions for up to three years. During the crisis, the Federation significantly increased the level of grant support to the regions. Often, the distribution of additional financial aid was carried out by the Federal government in a particularized mode, when the specific amount received by a

region depended on the actual indicators and dynamics of its revenues. Besides unconditional grants, significant targeted grants were allocated to support medical professionals.

In addition, the Federal government was able to organize additional direct payments to certain categories of the population, for example, to families with dependent children as well as to enterprises in certain industries (air carriers, hotels, restaurants, nonfood trade, etc.). At the same time, the regions were forced to increase spending to support the growing number of unemployed workers. Furthermore, tax revenues from small enterprises were decreased due to reduced business activity and a reduction of tax rates.

Further, we calculated the impact of COVID-19 on the regional budgets based on a correlation matrix (Table 1). Dependent variables (as of June 1, 2020) were as follows:

- (1) The ratio of public debt to the total revenue of the consolidated regional budget (%) – *DEBT*;
- (2) Share of federal grants as a percent of total revenues of the consolidated regional budget – *IFT*;
- (3) Share of surplus as a percent of total consolidated budget revenues – *PROF*;
- (4) Growth rates of regional budget revenues (compared to the same period in 2019) – *REV* and
- (5) Growth rates of regional budget expenditures (compared to the same period in 2019) – *EXP*.
- (6) COVID-19 patients (% of the total population) – *COVID*.

It should be noted that no clear relationship between budget parameters and the incidence of COVID-19 cases could be demonstrated. Although regional budgets seem to have gone up, this can be seen as a result of federal grants.

Conclusion

In general, 2020 may be the most difficult year for regional budgets, although the results of the first quarter did not show such a trend. The second quarter results were much more negative. After that, the nature of the crisis changed, and the fiscal indicators were more positive. In fact, fiscal resilience of regions was mainly supported by federal grants.

Many features will depend on how deep is the crisis caused by the coronavirus pandemic, and the unfavorable situation on world markets will be, as well as on the adequacy of the actions of the Federation regarding relations with regions, including fiscal ones.

However, the impact of COVID-19 on budget indicators of Russia's regions is ambiguous because the economic crisis of 2020 is twofold, including the crisis in the oil markets. The

	IFT	DEBT	PROF	REV	EXP	COVID
IFT	1					
DEBT	-0.027	1				
PROF	-0.156	-0.304	1			
REV	0.634	0.062	0.089	1		
EXP	-0.030	-0.027	0.133	0.148	1	
COVID	0.011	-0.029	-0.007	0.058	0.118	1

Table 1.
Correlation of COVID-19 with budget indicators

Note(s): Authors' calculations

pandemic has become a unique global phenomenon, the effect of which is difficult to identify and interpret outside of the economic aspects of life.

Notes

1. The authors analyze regional budgets (which are without local budgets) and consolidated regional budgets (in which local budgets are included).
2. Fiscal year (FY) in Russia begins on January 1.
3. Accounts Chamber of the Russian Federation. URL: <https://ach.gov.ru/en> (accessed 20 August 2020).
4. Russia's Electronic Budget. URL: <http://budget.gov.ru> (accessed 20 August 2020).
5. Federal Law of March 18, 2020 No. 52-FZ.
6. Federal Laws of April 1, 2020 No. 103-FZ and of April 22, 2020 No. 120-FZ.

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