Fiscal Decentralization
Intergovernmental Relations in Russia

Christine I. Wallich
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Foreword

The design of a well-functioning intergovernmental fiscal system is the key to Russia's macroeconomic stability, structural adjustment, provision of a social safety net during the difficult transition to a market economy, and political cohesion.

Macroeconomic stability cannot be achieved without fiscal balance at both the subnational and the national levels. In its effort to cut the federal budget deficit, the Russian government has transferred expenditure responsibilities—including a large share of the provisions for the social safety net and capital investment—to the subnational level while retaining incremental revenue at the federal level. Underfunded subnational governments, absent a system that provides for revenue-expenditure correspondence, are resorting to "coping mechanisms", including some that reduce budgetary transparency and threaten macroeconomic stability.

Privatization will also be impeded by the present system of intergovernmental finances. With the transfer of almost all enterprises to oblast and rayon ownership, responsibility for privatization now rests with subnational governments. Their interests here are unclear at best. As privatization proceeds, the subnational governments lose the profits and tax revenues from the enterprises. But they also have to assume the substantial "non-production" expenditures for hospitals, housing, schools, and other services, that the enterprises spin off when privatized.

Because Russia is in a period of nation-building with significant centrifugal forces emanating from the subnational level, intergovernmental finance is crucial to the future cohesion of the Federation. Dissatisfaction with the present system has provoked skeptical subnational governments to ask what functions will the center retain to justify their continued participation in the Federation? But the intergovernmental fiscal system, if it is carefully designed, can bind disparate regions into a stronger national entity.

This study is a product of the technical assistance program initiated in November 1991 by the World Bank in collaboration with the Ministry of Finance and several commissions of the Supreme Soviet of the Russian Federation to examine fiscal decentralization and intergovernmental fiscal relations. The study describes and analyzes the current system in Russia and makes recommendations for its reform. It also addresses the very divisive issue of how to share the potentially huge revenues from natural resource taxes in Russia as prices rise to world levels. And it highlights the important role the intergovernmental system can play in reducing political tensions.

The study is intended for policy makers and their advisers in the Russian Federation and other states of the former USSR. All those who are interested in social safety nets, macroeconomic stabilization, privatization, fiscal decentralization and the critical role of intergovernmental fiscal relations in facilitating a successful transition to the market economy should find this study useful.

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This study is based on background papers and other chapter inputs prepared by Bank staff and consultants under the Technical Cooperation Program on Intergovernmental Fiscal Relations in the Russian Federation. Among those contributing were: Roy Bahl (tax assignment issues and intergovernmental transfers); Jorge Martinez (expenditures and expenditure assignment); Charles McLure (sharing revenues from natural resource taxes); Jennie Litvack (special regimes and fiscal federalism); Helga Müller (the Russian system of intergovernmental finances); Philippe Le Houerou, Mario Blejer and Piroshka Nagy (macro-economic issues); and Horst Zimmerman (design of transfers).

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