Federal Transfers in Russia:  
Their Impact on Regional Revenues and Incomes

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Since 1991, the Russian system of federal intergovernmental transfers has moved from equalizing to counter-equalizing, both in the case of regional revenue equalization and in the case of regional personal income equalization. This change happened despite increasing revenue and income differentials and despite an introduction of a special equalization fund in 1994. The counter-equalizing effect has been weaker in real terms than in nominal terms indicating that regional price differentials have implicitly been taken into account. The main reasons for increasing counter-equalization seem to be: (i) a relatively small share of transfers in the budget and GDP; (ii) flaws in the equalization formula resulting in the lack of sufficient focus on the poorest regions; and (iii) a non-transparent character of other transfers redistributing often to the most politically powerful regions. The major recommendations for the future are (i) to increase (dramatically) the transparency of expenditure assignment, and (ii) to keep the system simple.

Cushioning asymmetric shocks by a system of intergovernmental transfers is commonly considered a desirable feature in a situation in which exchange rate instruments cannot be used for that purpose. This is why unitary states and federations have always been using intergovernmental transfers to equalize revenue and income. This is also why it is frequently argued

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that a common currency area in the European Union should be accompa-
nied by a union-wide transfer system to contain excessive disparities (Sala-
i-Martin and Sachs 1992). Using intergovernmental transfers for equaliza-
tion purposes may, however, discourage labor mobility and convergence
of productivity. Still, the transfers can be justified in such a situation on
equity grounds and because outmigration has social costs that are not in-
corporated in private decisions (Boadway and Flatters 1982).

We examine the impact of intergovernmental transfers on equalization
across the regions of the Russian Federation. How did federal transfers af-
fect regional revenue (fiscal) disparities in Russia in 1994 and 1995? What
has happened to personal income in the Russia’s regions over time? The
literature on the Russian fiscal federalism has already noticed significant
widening of existing budget disparities among regions in early transition
years and the lack of an explicit equalization mechanism in the period
inequality, as measured by various monetary and non-monetary indicators
(Murdoch, Brooks and Urinson 1994, Becker and Hemley 1996), has been
accompanied by revenue shortfalls (Wallich 1994). The equalization fund,
called the Federal Fund for Fiscal Support was introduced in 1994 to pro-
vide to provide for cross-regional equalization.

The Organization of Fiscal Federalism in Russia

The political and administrative organization of fiscal federalism in Rus-
ia is a unique blend of de jure federative organization and de facto ele-
ments of a confederation and of a unitary state, an organizational blend that
reflects the country’s size, diversity, and Soviet legacy. Russia’s subna-
tional governments consists of “subjects of the federation” that have very
different administrative and political status. The Russian Federation is made
up of 89 regions, consisting of 21 republics, 50 oblasts, 6 krais (native lands),
and 10 autonomous okrugs, plus 2 metropolitan cities (Moscow and St.
Petersburg) that are referred to collectively and officially as the 89 “sub-
jects of the federation.” The regions are further subdivided into more than
2,000 districts (municipalities and raions). All local governments within
a region report to the regional government and are subject to regional regu-
lations, though each local government has independent budgetary and ad-
ministrative status.

The law on the fundamentals of budget organization and budget process
of October 1991 lays out the principles of interbudgetary relations in Russia.
By establishing the independence of the budgets of all level of government,
this law broke with the previous unitary fiscal system. Fiscal independence