

## Governance and Regional Resilience in Russia: A Case Study of the Khanty-Mansiysk Autonomous Okrug

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### Abstract

Persistently among the leading regions of the country since the 1990s, Khanty-Mansiysk Autonomous Okrug, like most of Russia's resource abundant regions, was resilient in the aftermath of the global financial crisis, despite its exposure to international capital flows. In such resource abundant regions, long-run efficient and cooperative budget planning and performance largely account for their dynamic resilience.

### Economic Growth and Mineral Resource Abundant Regions

During the first decade of the century, the Russian economy rapidly improved. Between 2005 and 2011, GDP per capita rose annually by 4%, with one-quarter of Russia's then 83 regions growing by over 5% per annum, with some even reaching to 10 and 11%.<sup>1</sup> Although poverty diminished and there was regional convergence, the rise in per capita income left some regions well behind: northern regions lacking in minerals, southern regions overwhelmed by civil strife, and regions in the Urals overwhelmed by rural poverty and severe unemployment. Overall, 8% of all regions experienced between 0 and 1% growth per annum.<sup>2</sup>

Taking the lead since the 1990s, along with Moscow and St Petersburg, the resource-rich regions of Russia experienced a growth rate in 1992 that exceeded that of the slowest growing regions by 2.5 times, and in 2000 by 3.2 times. They now enjoy an enviable standard of living (see Figure 1 on p. 9).

All of these regions have a substantially larger than average per capita income. For the Khanty-Mansi Autonomous Okrug (KhMAO), for example, living standards reach those in Moscow city, as Table 1 on p. 10 demonstrates.

### Governance, 2000–2014

Resource regions retain their lead despite public sector reforms that have stripped them of much of their revenue. Most importantly, a 2001 law centralized the mineral resource extraction tax (MET) for the energy sector, and the regional share dropped to zero by 2010. For oil and gas revenues, most economists consider centraliza-

tion to be the best practice, since only the federal government has the capacity to stabilize the economy under conditions of price volatility.

All regions depend now for their revenue base on the one quarter of the corporate profit tax and the personal income tax that they receive according to Russia's budget federalism. The result, to be sure, is some centralization. But, by means of transfers and sharing, regions formally enjoy a substantial share of Russia's consolidated revenue. In 2011, they received 46.8% of Russia's overall revenue. Russia's regions' share of revenue is on a par with other federations: 34% in the US and 44% in Canada.<sup>3</sup> The property tax in 2011 was 9%, or 1.9% of Gross Regional Product (GRP), close to the OECD regional average.<sup>4</sup> Total regional tax revenues in Russia amount to roughly 11% of Gross Domestic Product (GDP) (Canada, 12.1%, Australia, 4%; Germany, 7.9%; and the US, 5%).

Budget reform was part of Russia's large-scale administrative reform throughout the 1990s and 2000s. Centralization was the priority objective, which gave the federal government not only all the revenue from the mineral extraction tax (MET), but also 100% of the value-added tax (VAT); allowing for the creation of a stabilization fund in 2004. The government also ended some perverse institutional effects from the Soviet era, including legacies from the past that subverted small business growth, tax collection, and social public spending in some regions. Since 2003, policies suppressing competition have largely been removed at the regional level. Conflict between federal and regional laws was eliminated, federal funding was tied to long run strategic development plans and modernization of public services across Russia, including improvements in the information infrastructure. Federal directives include a focus on small enterprise development in the regions, the bal-

1 The research leading to these results has received funding from the HSE Basic Research Program under grant agreement No. TZ-43/D. 95674.

2 The data are based on official government statistics by RosSTAT, chiefly *Rossiiskii Statisticheskii Ezhegodnik* (2000–2013), provided by Eastview for the University of Oxford online subscription service and by the National Research University-Higher School of Economics online resources.

3 Blöchliger, H. and J. Rabesona (2009). *The Fiscal Autonomy of Sub-Central Governments: An Update. OECD Working Papers on Fiscal Federalism*. Paris, OECD. 9:5.

4 0.5 to 1.5% of GDP, <<http://stats.oecd.org/Index.aspx?DataSetCode=REV>>

ancing of the regional budget and funds for unemployment relief and retraining of labor. In 2012, President Putin's "May 7 decrees" required improved standards of services, including a pay raise for government staff.<sup>5</sup>

In summary, reform resulted in a loss of regional political autonomy, but a gain of clarity and control in budget making. The clarified relations between levels of government increased the federal power to enforce the law, creating greater accountability through closer monitoring and more transparency thanks to uniform audit rules. The tax regime, to be sure, also reflects lobbying and cooperation among business, and federal and regional authorities. For example, a 2012 amendment to the Tax Code favored the oil sector by allowing unified tax assessments of voluntary consolidated taxpayer groups (CTG), intended in part to reduce overlapping payments of the profit tax to federal and regional levels. Regarding the performance of the public sector in the regions, current surveys reflect a mixed assessment: only 35% of the general public is satisfied with administrative effectiveness in the de facto privatized health care sector, but 63% of the populace is satisfied with administrative activity in the sphere of education. Among public sector reforms, the budget transformation was arguably the most impressive in strengthening the state to accomplish this goal.

### Impact of the Global Financial Recession

In 2009, public administration reform in Russia was severely tested by the global financial crisis. The government introduced new measures to help regions withstand the impact of global recession, but by 2011, it was evident that most regions, due to their relative lack of exposure to global finance, avoided a devastating impact. So, regional budgets were continually tightened afterwards. For example, in 2013, even though the corporate income tax fell by 20%, transfers were 7% lower than in the previous year.<sup>6</sup> Regional reform encourages them to rely on credit to cover deficits. The federal level is reducing transfers to weak regions to end their dependency on federal subsidies. It encourages regions to take greater initiative in attracting investment resources, to compete with other regions, and carry out efficiency measures.

As a result, many regions have borrowed heavily, but the results are probably not as extreme as sometimes portrayed. For example, in 2013, Natalia Zubarevich, a regional expert at Moscow State University warned that "...regional budgets are buckling. Revenues in the first half of 2013 decreased due to a 20% decline in profit tax revenue and a 15% cut in federal budget transfers. Meanwhile, spending grew 5% to fulfill the president's promises to increase public sector wages. Budgets are running deficits in two thirds of all regions, and aggregate regional and municipal debt has surpassed 25% of (tax and non-tax) revenue. The regions are reducing investment spending, but it's not enough. ...the decline in public sector employment is accelerating. ...Laid off workers have difficulty finding another job."<sup>7</sup>

Total public debt of sub-national entities increased by 15.6% in 2012 (RIA Rating, 12 March 2013). However, the wealthiest regions have most of the outstanding regional bonds: Moscow, Krasnoyarsk, Nizhnyi Novgorod, Samara and Moscow oblasts (64%), and these are regions that can easily cover their obligations. Also, the term structure of obligations and debt service matter.<sup>8</sup> Russia's debt service is high, about 10% of revenues; but debt ceilings as a percent of GRP are about the same as for states in the US, 5%.<sup>9</sup>

### Khanty-Mansiy Autonomous Okrug: Recession and Recovery

KhMAO is one of only seven regions (including Moscow and St Petersburg) that maintains an investment-grade rating by two rating agencies, permitting it to obtain funds in international capital markets, where interest rates are considerably lower (8–10%) and repayment extends over a longer period (3–5 years) than those available in the rest of Russia.

The global recession had a severe impact on the economy of the resource regions. Profit and income tax fell in Chelyabinsk and Kemerovo by 90%. After the worst of the crisis, however, the liquidity of banks in resource regions, such as KhMAO, quickly recovered and oil and gas firms' profits rose once again. Debt remained low in KhMAO, with regional and municipal debt amounting to 0.8% of GRP in 2013.

The rapid recovery is one sign of financial resilience, defined as the ability of a region to minimize aggre-

5 For example, as implemented by decree, "O forme i stroke predstavleniia zaiavki na perechislenie subsidii iz federal'nogo biudzheta biudzhety sub'ekta Rossiiskoi Federatsii na sofinansirovanie raxkhodnykh obiazatel'sv sub'ekta Rossiiskoi Federatsii...ot 7 maia 2012 goda N 606, Prikaz Ministerstva truda i sotsial'noi zashchity Rossiiskoi Federatsii ot 29 noiabria 2012 goda N556H.

6 A. Cherniavskii, "Regioinal'nye biudzhety v period stagnatsii," October 2013, Tsentr Razvitiia, NRU-HSE, <[http://dcenter.hse.ru/sam\\_bd](http://dcenter.hse.ru/sam_bd)>

7 N Zubarevich, *Vedomosti* No.175 (3437) September 24, 2013 What's Next for the Four Russias?

8 A. Cherniavskii, "Regioinal'nye biudzhety v period stagnatsii," October 2013, Tsentr Razvitiia, NRU-HSE, <[http://dcenter.hse.ru/sam\\_bd](http://dcenter.hse.ru/sam_bd)>

9 T. Dinopoli, "Debt Impact Study: An Analysis of New York State's Debt Burden" (Office of the State Comptroller, January 2013), p. 30; <<http://www.osc.state.ny.us>>

gate investment and program losses. Dynamic resilience describes a region that succeeds in rapid reconstruction afterwards, enabling it to retain its leading position independent of the severity of a one-time loss. The region adjusts the distribution of losses, protects vulnerable households' pre-crisis income and smooths shocks over time with savings, borrowing, and insurance, and the social protection system.

Migration data for KhMAO show that oil, price, and production shocks have not affected outmigration of highly mobile unemployed labor from the region, as shown below in Figure 2 on p. 10.

### Conclusion

Among resource regions, KhMAO is a leader in economic growth. The profit tax from the oil and gas sector in 2012 made up some 95% of KhMAO's operating income, and revenues from the majors comprised 52.1% of total revenue.<sup>10</sup> Falling extraction at major fields and a dip in the share of oil in GRP to less than half (43.6%) has not dented that leadership.

By 2030, according to the region's Energy Strategy to 2030, annual production of oil will fall, at a minimum, from 260 to 222 million tons, and more likely, to 196

mt. Fracking will help to increase production, but costs of extraction will rise at the same time due to flooding and technological challenges.<sup>11</sup> Although fracking technologies are freely available, hydraulic fracturing, horizontal drilling, three-dimensional seismic modeling are especially costly in the initial stages.

The KhMAO budget for the post-crisis years is an example of how a severe crisis can be rapidly overcome in one of Russia's resource rich regions. KhMAO reestablished its surplus without going deep into debt and while also covering the new 2012 requirements for increased salaries and other obligations announced in President Putin's "May decrees."

Ultimately, the resilience of KhMAO, and other resource regions, results from a number of factors: avoidance of dependence on budgetary subsidies from the federal government; geopolitical factors, including the region's ability to attract large energy and industrial companies; the development of new clusters other than in the oil sector; a social protection program; and a high level of administrative skills. There is also evidence of within-region cooperation of public and private sectors and inter-regional coordination to secure flexibility on tax allocations and spending requirements.

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<sup>10</sup> <[http://www.fitcratings.ru/rws/press-release.html?report\\_id=804352](http://www.fitcratings.ru/rws/press-release.html?report_id=804352)>

<sup>11</sup> RIA Novosti (19/04/2013), "Vlasti luryg ishchut sposobny sderzhat' padenie nefte dobychi v regione" <<http://m.ria.ru/analytics/20130419/933482745.html>, accessed 27/01/2014>



Table 1: Standard of Living Indicators: Khanty-Mansiy Autonomous Okrug, Moscow city, Russian Federation average (2011)

|                             | Average Expenditure per household member, rubles per Month |             |                     |                               |                         | % Households on Internet | Average Income per Household Member, Rubles per Month |                                  | Minimum Sustainable Monthly Income Set by Region |
|-----------------------------|--|-------------|---------------------|-------------------------------|-------------------------|--------------------------|---|----------------------------------|--|
|                             | Disposable Income  | Consumption | Expenditure on Food | Expenditure on Non-Food items | Expenditure on Services |                          | Income Poor Households                                | Income Extremely Poor Households |  |
| Average, Russian Federation | 15,816   | 10,460      | 3,250               | 4,178                         | 2,615                   | 53                       | 4,858   | 2,637                            | 6,090  |
| City of Moscow              | 25,629   | 21,145      | 4,720               | 8,220                         | 6,900                   | 82                       | 8,287   | NA                               | 8,656  |
| Khanty-Mansiysk AO          | 27,061   | 15,278      | 3,240               | 7,112                         | 4,494                   | 71                       | 7,094   | 3,073                            | 5,234  |

Source: Rosstat.

Figure 2: Oil Extraction and Population, KhMAO, 1959–2012

