

INTERGOVERNMENTAL RELATIONS IN RUSSIA: STILL A PENDULUM?¹

Yushkov Andrey

M. Sc. (Econ.), Research Fellow, International Centre for Socio-Economic Research “Leontief Centre”.
Address: 25, 7th Krasnoarmeyskaya Str., 190005,
St. Petersburg, Russian Federation.
E-mail: yushkov@leontief.ru

Savulkin Lev

Cand. Sci. (Geog.), Senior Research Fellow, International Centre for Socio-Economic Research “Leontief Centre”.
Address: 25, 7th Krasnoarmeyskaya Str., 190005,
St. Petersburg, Russian Federation.
E-mail: savul@leontief.ru

Oding Nina

Cand. Sci. (Econ.), Head of Research Department, International Centre for Socio-Economic Research “Leontief Centre”.
Address: 25, 7th Krasnoarmeyskaya Str., 190005,
St. Petersburg, Russian Federation.
E-mail: oding@leontief.ru

Abstract

This paper studies political, economic and administrative aspects of intergovernmental relations in Russia since the beginning of the 1990s. We distinguish three stages in the development of Russian federalism, which differ from previous classifications available in the literature – the pendulum of (de)centralization (1991–2003), critical crossroad with the radical shift back to the centralization path (2003–2005), and the era of further pervasive centralization and transformation to the de facto unitary state (2005–present). At the latest (third) stage, we identify two mechanisms of centralization – linear and non-linear, which differ in their design but similarly contribute to the general trend, and provide several supporting examples of both of them.

Keywords: federalism, intergovernmental relations, political economy, Russian regions.

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Introduction

Federalism, which in the widest sense means the assignment of powers, responsibilities and financial resources between different levels of government

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in a federal state, and intergovernmental relations are equally popular research topics for experts in public administration, economists and political scientists. Nevertheless, researchers, who consider the economic and fiscal foundations of federalism in theoretical or empirical studies², often ignore the political and administrative aspects of this phenomenon. Conversely, political scientists prefer to study federalism as a purely political concept³, without going into the details of the assignment of financial resources between different levels of government and respective administrative procedures. Still, the task of combining the politics and economics of intergovernmental fiscal relations and studying the political economy of federalism is becoming highly relevant nowadays.

Russian federalism has been the subject of numerous articles by academic researchers and experts from international organizations since the collapse of the USSR and the beginning of spontaneous political, administrative and economic decentralization. Early steps to reform fiscal federalism and the stage of formalizing intergovernmental relations were considered by Zhuravskaya (2000, 2010), Lavrov, Litwack, Sutherland (2001), Alexeev and Kurlyandskaya (2003), Pascal (2003), Lavrov and Klimanov (2004), Shleifer (2005), Martinez-Vazquez, Timofeev and Boex (2006), and Freinkman and Plekhanov (2009). A complete monograph on the economic aspects of intergovernmental fiscal relations in Russia belongs to the team of authors of the World Bank (De Silva et al., 2009). The relationship between intergovernmental transfers and electoral behavior in Russian regions was considered in the articles of Treisman (1996), Popov (2004), Jarocinska (2010), and Yakovlev, Marques and Nazrullaeva (2016). The political aspects of Russian federalism were the subject of articles by Golosov (2004), Slider (2005), Stoner-Weiss (2005), Gel'man (2006), and Gel'man & Ryzhenkov (2011).

In this study, we examine the political economy of intergovernmental fiscal relations in Russia since the early 1990s, with a particular emphasis on the latest stage of federalism development. We also try to answer the question on whether the pendulum of (de)centralization is still moving and, if so, whether the political and economic centralization trends of Russian federalism coincide.

We argue that the pendulum of Russian federalism (from Soviet-style centralization to decentralization in the early and mid-1990s and the recentralization of the early 2000s) transformed into a new state. In our viewpoint, a long and steady period of centralization has begun since the beginning of the 2000s without a return to decentralization.

We identify two different types of centralization mechanisms in this latest period – linear and non-linear (stepwise). The latter can take various forms, but its long-term trend is still linear.

² Tiebout (1956), Musgrave (1959), and Oates (1972) developed the modern theory of fiscal federalism. The extensive review of early studies can be found in Oates (1999). Weingast (2009, 2014) and Inman and Rubinfeld (2014) summarize the second-generation theory of fiscal federalism, as well as the newest theoretical and empirical studies on this topic.

³ The political science of federalism is the main subject of the classic monographs of Riker (1964) and Elazar (1987). The modern approach to the politics of federalism can be found in the works of Bednar (2009, 2011, and 2014).

Intergovernmental relations in Russia at the stage of fiscal federalism formation (1991 – early 2000s)

With the collapse of the Soviet Union and the beginning of the formation of a new Russian statehood, macroeconomic instability and low tax collection have become one of the biggest problems of the federal government. In order to deal with the revenue gap, which was quite high in comparison with other transition economies, the federal government significantly reduced overall public expenditure and transferred a number of expenditure responsibilities to subnational governments. The share of regional and local (municipal) government spending in the consolidated budget of the Russian Federation increased dramatically from 23.7% in 1992 to 43.8% in 1994 (23.4% – expenditure of regional governments, 20.4% – expenditure of local governments) (De Silva, Kurlyandskaya, 2006, p. 8). Such a spontaneous expenditure decentralization required the additional revenue sources of subnational governments. In order to achieve a political compromise, the federal government implemented the system of shared taxes – regional governments received a particular, usually quite high, share of federal taxes (personal income tax, corporate profit tax, VAT, mineral resource taxes).

Political and administrative aspects

On March 31, 1992, the federal government and the regions (all except Tatarstan and Chechnya) signed the Federal Treaty on the division of powers and responsibilities. It consisted of three separate agreements between the federal government and the three types of region (republic; krai, oblast and federal city; autonomous oblast and autonomous district). Several strong regions started negotiating towards bilateral agreements with the federal center that could provide them with enhanced powers and other favorable political and economic conditions (De Silva et al., 2009).

The Constitution of the Russian Federation of December 12, 1993, adopted as a result of a national referendum, enshrined a symmetrical federation. According to Article 5, “in relations with federal bodies of state authority, all the subjects of the Russian Federation shall be equal among themselves.” Nevertheless, the Constitution also “recognized the possibility of an asymmetric configuration of intergovernmental relations” (Martinez-Vazquez, Timofeev, Boex, 2006, p. 6) in that its Article 11 allowed not only the Constitution and the Federal Treaty but also *other treaties* to fix the division of powers among the Russian Federation and the regions. The second section of the Constitution declared its supremacy over the norms of the Federal Treaty. Hence, since then Russia has *de-jure* become a constitutional, not a contractual, federation.

The regions and the federal government used these *other treaties* extensively throughout the 1990s. Until 1995, the federal center signed bilateral treaties almost entirely with ethnic republics (e.g., Tatarstan, Bashkortostan, Kabardino-Balkar Republic) in order to assign additional powers to them and even discuss issues regarding the mutual delegation of authority. After 1995, it started to extend this practice to other types of region (Martinez-Vazquez, Boex, 2001). By 1998, forty-six regions had a treaty with the federal government, which contributed to the increased asymmetry both among the regions (in favor of ethnic republics and

wealthy regions) and between the federal center and subnational governments. After 2000, the attitude of the federal government towards treaties changed dramatically. Federal Law 119 of June 24, 1999, established the priority of the federal laws over the treaties. In 2001–2002, the federal government and the regions signed 28 bilateral or tripartite acts on the termination of treaties. In the latest stage of Russian federalism development, the practice of individual delimitation of powers using treaties came to nothing, and only a few regions, mainly ethnic republics and donor regions, have had similar agreements in recent years.

Table 1

Intergovernmental relations in Russia: main stages since 1991

Stage	Pendulum of (de)centralization	Critical crossroad: back to a centralized state	Pervasive centralization
Years	1991–2003	2003–2005	2005–present
Political aspects	<ul style="list-style-type: none"> – Spontaneous political decentralization in the early 1990s, – Adoption of the Federal Treaty, the Constitution and bilateral federal-regional treaties, – By 1997, all regional governors elected by popular vote, – Federation Council comprised of regional governors and heads of regional legislatures (until 2000), – Establishment of seven federal districts 	<ul style="list-style-type: none"> – Abolition of regional governors' elections in 2004 and establishment of additional rights of the President to dismiss governors and regional legislatures, – Change in the procedure of State Duma elections that undermined the political power of regions, – De-facto nationalization of local self-government; – Mergers of regions 	<ul style="list-style-type: none"> – Return of regional governors' elections, but with significant restrictions and filters, – Establishment of a half-party system at all levels of government, – Crowding out of subnational economic incentives by political incentives, – Loss of independence of regions and municipalities, and intimidation policies against regional and local officials
Economic aspects	<ul style="list-style-type: none"> – Spontaneous economic decentralization in 1992–1994, – Introduction of numerous regional and local taxes that contradicted the federal legislation, – Formalization and unification of tax and budget systems since the mid-1990s, – Start of fiscal recentralization after the crisis of 1998 	<ul style="list-style-type: none"> – Adoption of and significant amendments to federal laws regulating powers and responsibilities of subnational governments, – Radical decrease in tax autonomy of regions and municipalities 	<ul style="list-style-type: none"> – Further redistribution of taxes in favor of the federal center, – Strengthening the dependence of regions and municipalities on transfers, – Quasi-decentralization of (mandatory) expenditure responsibilities
Results	The pendulum was moving from Soviet centralization to chaotic decentralization of the early 1990s and back to recentralization at the beginning of 2000s	The paradigm of intergovernmental relations and its administrative mechanisms overcame a critical shift: only one “veto player” stayed in the game – the federal government	New state of the system of intergovernmental relations with unstable centralized equilibrium and the continuing search for the optimal state

A spontaneous transfer of institutional, administrative, and economic resources to the regions occurred in 1991–1998. As noted by Gel'man (2006), the decentralization of the 1990s was anything but a consequence of the conscious policy of the federal center. The factors that influenced this spontaneous decentralization included the ethnic model of federalism created in the Soviet period, the uneven socio-economic development of the territories, the outburst of ethnopolitical conflicts; weakening of the administrative capacity of the federal center (Stoner-Weiss, 1999; Ross, 2002). As a result, the federal government lost its control over regional political processes, and regional elites, especially from wealthy and ethnic regions, became a “veto group” in intergovernmental relations.

A prominent example of political decentralization was the establishment of regional elections. In 1991, citizens elected the heads of regions (governor, mayors, and presidents) in Moscow, St. Petersburg and six ethnic republics, while Chechnya held the unrecognized elections of their president. Federal Law 192 of December 5, 1995, required the regions to organize the governors' elections by the end of 1996 (in those regions, where governors were still not elected by popular vote), which finally strengthened regional political independence. Every region had complied with this requirement by 1997. Since 1996, regions have held governors' elections 143 times. During the period from 1991 to 2001, only in 10 of the 186 cases did the heads of regions not take part in the elections. In 118 cases, the former governor or a member of his team won the election. Of the 58 cases where the incumbent or his protégé lost the election, in nine cases they even failed to come in second place (Enikolopov et al., 2002, p. 8). Despite the possible arguments about state capture by regional (business) elites and non-transparent electoral procedures, we can argue that competitive elections took place in the majority of regions throughout the 1990s.

A robust and powerful Federation Council, an upper chamber of the Federal Assembly (Russian parliament), was another example of the spontaneous decentralization of the early and mid-1990s. With the adoption of Federal Law 192, only heads of the regional executive and legislative bodies (governors and speakers of regional parliaments) could become members of the Council. On the one hand, this raised the status of the parliament; on the other hand, it was a weakness since new members were preoccupied in their regions and could not regularly attend Council sessions (Ross, 2010). In the 1990s, the Federation Council often voted in favour of overcoming the presidential veto and acted as a “filter” for the laws adopted by the State Duma. However, it had become weaker by the end of the 1990s and failed to use its right of legislative initiative (see Ross (2010) for an extensive discussion).

A significant decrease in the role of the Federation Council followed the adoption of Federal Law 113 on August 5, 2000. Instead of the heads of the regional executive and legislative bodies, the regions had to delegate new permanent members of the Council. It turned out that these new delegates often had little to do with the region they represented. As noted by Ross (2010), 75–80% of new the senators' appointments were recommended by the presidential administration; 45% of them were Moscow-based and did not spend much time in the regions that appointed them.

The Presidential Decree 849 issued on May 13, 2000, introduced seven federal districts (*federalnyye okruga*) that further undermined the status of the governor and introduced a new element of control into intergovernmental relations.

Economic aspects

Federal Law 2118-1 of December 27, 1991, determined which taxes were collected at all levels of the budget system and their distribution among levels of the government. In 1994, all of the regions received equal powers regarding taxation⁴, they were assigned equal sharing rates from federal taxes, but these sharing arrangements changed annually.

According to the Presidential Decree 2268 of December 22, 1993, the regional and local authorities were entitled to impose taxes not included in Federal Law 2118-1. As a result, the approximate number of regional and local taxes reached 200 by 1996 (Lavrov, 1999, p. 38). New taxes and fees aimed at subsidizing certain sectors of the economy emerged in many regions. Charges for the import of goods to and export from the region became widespread. This practice was especially distinctive in the case of alcohol products. The Republic of Mordovia introduced a 10% sales tax on all excisable goods imported into the region. Oryol and Sverdlovsk oblasts set fees for the import of food products. Such activities of regional governments were contrary to Article 74 of the Constitution, which prohibits the introduction of any restrictions on the movement of goods and services within the country.

Bilateral treaties between the federal government and the regions signed in 1994–1997 also contained the fiscal policy agreements and special tax privileges for several ethnic republics and the better-off regions. For instance, the republics of Tatarstan and Bashkortostan, and St. Petersburg could keep up to 100% of some federal taxes collected in the region; the Udmurt Republic, Khabarovsk Krai, and Irkutsk oblast had individual agreements over intergovernmental transfers; other regions could receive compensation for federal mandates, use federal taxes to cover federal expenditures in the region, have agreements over tax-sharing rates, and get other fiscal powers (OECD, 2000).

Insufficient clarity in the division of tax revenues between the federal government, regions, and municipalities in the 1990s was present because revenues from regulated (shared) taxes accounted for about 30% of regional budget revenues and 40% of local revenues. Tax rates and sharing rules for these taxes (which included VAT, personal income tax, excises, mineral tax, etc.) were set annually by the higher level of government (OECD, 2000). The distribution of tax revenues between the municipalities was entirely at the discretion of the regional governments. Only a few regions (including the Nizhny Novgorod, Novgorod, and Novosibirsk Oblasts) signed (and fulfilled) long-term agreements on the sharing of revenues with local governments (Enikolopov et al., 2002). The fiscal incentives of municipalities were arguably quite weak in the 1990s due to the lack of predictability of tax revenues and no guarantee that they would increase in the case of local efforts to raise the tax potential (Zhuravskaya, 2000; Alexeev, Kurlyandskaya, 2003; critical discussion – Shishkin, 2013).

⁴ By the Federal Law 9 “On the Federal Budget for 1994” of 1.07.1994

The Presidential Decree 1214 of August 18, 1996, ordered the regional authorities to abolish taxes and fees that are not provided for in federal legislation from January 1, 1997. The Komi Republic, the Altai Krai, Vladimir, Volgograd and Irkutsk Oblasts attempted to challenge this decision in the Constitutional Court of the Russian Federation, but without success (Lavrov, 1999). Only with the adoption of the Tax Code (Federal Laws 146 and 117 of 31.07.1998 and 05.08.2000), and the Budget Code (Federal Laws 145 of 31.07.1998) and subsequent changes in the legislation, a closed list of federal, regional and local taxes and fees was established, which fixed the distribution of taxes between different levels of government (see Table 2).

Table 2

Federal, regional and local taxes in Russia in 1998 and 2017

Federal taxes	Regional taxes	Local taxes
Value added tax⁵	Enterprise property tax	Land tax
Excises	Transport tax	Personal property tax
Enterprise profit tax	Gambling tax	Advertising tax
Personal income tax	Sales tax	Inheritance tax
Customs duties	Road tax	Local license fees
Mineral tax	Regional license fees	Trade fee for Moscow and St. Petersburg
Water tax	Tax on housing maintenance	
Fee for the right to use objects of fauna and water biological resources		
Tax on the use of subsoil		
The tax on the reproduction of the raw materials base		
Tax on additional income from hydrocarbon extraction		
Contributions to state off-budget funds		
Forest tax		
Tax on capital gains		
Environmental tax		
Federal license fees		

Source: Lavrov (1999) and Tax Code of the Russian Federation (ed. 2017)

From 1998 to 2005, an active redistribution of revenues between the levels of the budget system took place (see Table 3). In 1999, the federal government's share of personal income tax collections increased from 0% to 24%, which can

⁵ Taxes highlighted in bold are being currently collected at respective levels of government.

be explained by the severe economic crisis of 1998 and the necessity to compensate the dramatic fall of federal budget revenues. After 2001, this share fell to 0% again, and the personal income tax accumulated in the consolidated regional budgets. The distribution of the enterprise profit tax started to change in 1999, and from then the share of regions grew steadily. In 2001 the tax rate attributed to the federal budget was 11%, regional budgets – 19%, and municipal budgets – 5%. In 2002, the maximum profit tax rate fell from 35% to 24%, and the distribution among different levels of government changed accordingly (federal budget – 7.5%, regional budgets – 14.5%, and municipal budgets – 2%). At the same time, the ability of the regions to change the rate of this tax was significantly limited (it could be reduced by no more than 4%). The share of value added tax (VAT), which went to the federal budget, increased from 75% before 1998 to 85% in 1999–2000 and 100% after 2001. Centralization of natural resource rents started in 2002 when the federal share of the tax on the production of hydrocarbons increased from 40% to 80% (later on, this tendency continued with the newly introduced mineral tax – *NDPI*). As a result of these changes, the tax revenues of the “average” region decreased by 21% (De Silva & Kurlyandskaya, 2006).

Overall, regions and municipalities became more dependent on the federal government after 1998, and their share of revenues in the consolidated budget of the Russian Federation decreased from 57% in 1998 to 46% in 2000 and 38% in 2002–2003 (see Figure 2). We believe that this was the beginning of the linear centralization of tax revenues in the federal budget. Another tendency during this time was a decrease in the diversification of regional tax revenues due to the transfer of all receipts from VAT to the federal level and the abolition of the tax on housing maintenance as well as some other taxes (see Table 2). Since the early 2000s, two major taxes (personal income tax, enterprise profit tax), for which the federal center determined tax rates and bases, have comprised almost 70% of regional budgets.

In the 1990s, not only the federal government experienced budget deficits, but also many regions did, thus making the instrument of intergovernmental fiscal transfers vital for the whole budget system. The federal government provided unconditional transfers (*dotacii*) from the Federal Fund for Financial Support of Regions established in 1994 to cover the gap between current expenditures and revenues of regional budgets (gap-filling transfers). Initially, there was no formula-based allocation of these transfers⁶, which did not stimulate regions to develop their tax potential. The practice of providing additional transfers called *mutual settlements*, an umbrella category that the federal government used to finance regional investment programs, to compensate regional governments for carrying out federal government mandates⁷, or to provide emergency aid (De Silva et al., 2009), became widespread. During the mid-1990s, mutual settlements were the largest type of intergovernmental transfers to regions and municipalities – their

⁶ Formula-based allocation that used fiscal capacity index and the index of expenditure needs was introduced in 2001, and then changed in 2005.

⁷ The inability of the federal government to compensate for all such mandates created the famous problem of “unfunded mandates” that was critical in the mid-late 1990s and has become relevant again nowadays.

share in total transfers was 35–40% in 1995–1998. As the OECD research team points out, “such settlements usually represent the result of bilateral negotiations and political lobbying” (OECD, 2000, p. 135). The federal government stopped using mutual settlements only after 2001, when the current system of transfers that consists of unconditional transfers, subsidies, subventions, and “other transfers” emerged. In general, the share of transfers in subnational budget revenues fluctuated a lot during the 1990s (around approximately 15% – see Figure 4). It rose during the 1998 crisis as well as after the centralization of VAT in 2001, but, on average, was much lower than at the latest stages of fiscal federalism development. Notably, the dependence of local governments on the region have been higher than the dependence of the region on the federal government almost the entire time since the early 1990s. In the late 1990s the share of transfers in local revenues was around 30% (OECD, 2000).

Results of this stage

The actions of the federal government during the transition period were, in most cases, a reaction to the centrifugal tendencies and turbulence of the political situation. Ultimately, it was reflected in spontaneous political decentralization in the early 1990s and the emergence of influential regional centers with popularly elected governors. After 2000, with the abolition of many federal-regional treaties, changes in the structure of the Federation Council, and the creation of federal districts, this tendency reversed.

Intergovernmental fiscal relations between the federal center and the regions fluctuated a lot during this period⁸: from the spontaneous decentralization of the early 1990s through to the formalization of the institutional environment of the late 1990s to the return of centralization tendencies, which reached their culmination at the critical stage of 2003–2005. Hence, we can consider this period as a synchronous pendulum motion of political and economic (de)centralization, which transformed into a new state at the latest stage of fiscal federalism development.

The critical crossroad in the development of intergovernmental relations – transition to the centralized state (2003–2005)

We believe that the critical turning point in the development of modern Russian federalism was the period from 2003 to 2005. Before 2003, according to some researchers (Shleifer, 2005, Zhuravskaya, 2007), it was still possible to reform federalism in the Chinese style (by combining political centralization with significant economic decentralization and extensive fiscal autonomy of subnational authorities), but after 2005 it became evident that a robust and stable trend towards political and economic centralization had started.

⁸ Some researchers referred to this period as an example of “state-corroding federalism” (Cai, Treisman, 2004) since the powerful regional elites protected local firms from paying federal taxes, thus reducing overall welfare. See the review of empirical literature on state capture and state-corroding federalism in Russia in Zhuravskaya (2010).

Table 3
Sharing rates for the main taxes between different levels of government in Russia (1994–2017), %

Tax	1994	1996	1998	1999	2000	2001	2002	2003	2004	2005	2011	2017
Enterprise profit tax ¹	F	13	13	11	11	11	7,5	7,5	7,5	6,5	2	3
	R	22	22	19	19	19	14,5	14,5	14,5	17,5	18	17
	L					5	2	2	2	0	0	0
Personal income tax ²	F	0	10	0	24	16	0	0	0	0	0	0
	R	100	90	100	76	84	50	50	50	70	70	85
	L						50	50	50	30	30	15
Value added tax	F	75	75	75	85	85	100	100	100	100	100	100
	R	25	25	25	15	15	0	0	0	0	0	0
	L						0	0	0	0	0	0
Mineral tax ³	F	-	40	40	40	40	80	100-g 86-o	100-g 95-o	100-g 95-o	100	100
	R	-	30	30	30	30	20	0-g 14-o	0-g 5-o	0-g 5-o	0	0
	L	-	30	30	30	30	0	0	0	0	0	0
Enterprise property tax	F	0	0	0	0	0	0	0	0	0	0	0
	R	50	50	50	50	50	50	50	50	100	100	100
	L	50	50	50	50	50	50	50	50	0	0	0

¹ for enterprise profit tax, tax rates are shown (their sum gives a marginal tax rate of this tax)

² in the early 2000s, regional governments could establish additional sharing rates for the personal income tax with municipalities as an alternative to unconditional transfers – therefore, actual sharing rates differed from the 50/50 rule

³ before 2003 – tax on the production of hydrocarbons (oil & gas), after 2003 – separate types of the mineral tax for oil and gas

Source: De Silva, Kuriyandskaya (2006), Freinkman, Plekhanov (2009), Tax and Budget Codes of the Russian Federation

The governing ideology of the federal government began to dominate over utilitarian and self-governing ideologies (see Gel'man (2006) for a discussion of these ideologies) as a result of transformations that occurred in 2003–2005. Some researchers adhere to a slightly different periodization of this stage in the development of intergovernmental fiscal relations – Gel'man (2006) believes that centralization trends had already begun in 1998 and reached a peak in 2005. Ross (2010) notes that the critical point was during the period of “2003–2006, when the number of laws was adopted that have severely weakened the powers and competencies of the regions, and transformed Russia into a quasi-unitary state”. World Bank experts suggest that the period of fiscal recentralization started in 2005, although some centralizing tendencies were present from the beginning of the 2000s onwards (De Silva et al., 2009).

This section presents the most important aspects of centralization undertaken by the federal government between 2003 and 2005, which the authors of this article consider to be the key to the subsequent development of intergovernmental fiscal relations in Russia.

Political and administrative aspects

In 2003, a key federal law regulating the powers of local self-government (Federal Law 131⁹) was adopted, while the federal law regulating the powers of Russian regions on subjects of joint competence (Federal Law 184¹⁰) was significantly amended. Federal Law 131 was adopted despite protests from representatives of municipalities and left-wing parties of the State Duma; in fact, it meant the nationalization of local self-government (Gel'man, 2006). This law presupposed the division of municipalities into several levels, mandatory inter-municipal equalization, shifting the responsibility for solving issues of local importance to municipalities without providing them with the necessary resources to implement the powers. The adoption of this law and its entry into force in 2006 was the first step towards reducing the political and fiscal autonomy of municipalities.

In 2004, two additional federal laws were adopted that redistributed a considerable number of powers between the levels of government (Federal Law 122 of 22.08.2004 and Federal Law 159 of 11.12.2004). These laws transferred several powers from the joint jurisdiction of the federal government and the regions to the sole competence of the federal center (Ross, 2010). In particular, they reduced the powers of regions in the fields of natural resources, timber, and water.

In addition, in 2004, under the pretext of the need to strengthen the power vertical in the fight against terrorism, direct regional governors' elections were abolished, and a new procedure for their appointment was introduced (Federal Law 159 of 11.12.2004, Presidential Decree 1603 of 27.12.2004). This measure contributed to the gradual replacement of many regional leaders elected in the early 1990s by the new executives loyal to the federal center and often having

⁹ Federal Law 131 “On the General Principles of Organizing Local Self-Government in the Russian Federation” of 06.10.2003

¹⁰ Federal Law 184 “On the General Principles of Organizing Legislative (Representative) and Executive Bodies of State Power of the Subjects of the Russian Federation” of 06.10.1999

no relation to the region entrusted to them, and also undermined the accountability of regional officials to citizens.

In 2005, the procedure for State Duma elections was changed (Federal Law 51 of May 18, 2005). Instead of the mixed system with single-member districts of the 1990s, a proportional electoral system was introduced and the threshold for eligibility to win seats was raised to 7%, which led to an increase in the control of the lower chamber of the Federal Assembly and a decrease in the role and representation of regions. The redistribution of powers between different levels of government also continued: by Federal Law 199 of 31.12.2005, the regions received more than 100 additional powers, but most of them were either regulated by the federal government or were unfunded mandates as the regions did not have enough financial resources to implement them fully.

As a result of strengthening the role of the regional bodies of federal ministries and services, the number of federal executive officers in the regions grew from 467,000 in 2001 to 577,000 in 2003 and 786,000 in 2006¹¹. This is significantly (2.5–3 times) higher than the number of officials of regional executive bodies.

Another tendency of this critical period was the beginning of the merging of regions in Siberia and Far East of Russia. Perm and Kamchatka Krai emerged in 2005, while Krasnoyarsk Krai became much larger due to the territorial changes in 2005–2007¹². As a result, the number of autonomous districts significantly decreased after this reform, while relatively wealthy regions had to acquire poor neighboring territories, thus becoming more dependent on federal transfers and less politically independent since the elected governors of merging regions were appointed by the new procedure.

Economic aspects

Political centralization was accompanied by further formalization of intergovernmental fiscal relations and a significant decrease in the autonomy of subnational authorities due to a reduction in the revenue base and the emergence of new powers (outlined in Federal Laws 184 and 131) that were binding for the regions.

The most important change in intergovernmental fiscal relations was the abolition of the norm that the tax revenues of regional budgets must not be less than 50 percent of the consolidated budget revenues of the Russian Federation (Article 48 of the Budget Code abolished by Federal Law 120 of 20.08.2004). Furthermore, the number of regional and local taxes was significantly reduced in the new editions of the Tax Code and the Budget Code. Federal Law 120 and Federal Law 95 of 29.07.2004 abolished several regional taxes (road tax, sales tax – partially returned in 2015 for Moscow and St. Petersburg, tax on real estate, and regional license fees) and local taxes (advertising tax, inheritance tax, and local license fees). After these changes, only three regional taxes (property tax, gambling tax and transport tax) and two local taxes (personal property tax and land tax) remained in Russia.

¹¹ Statistical database “Labor and Employment in Russia” by Rosstat (http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/publications/catalog/doc_1139916801766)

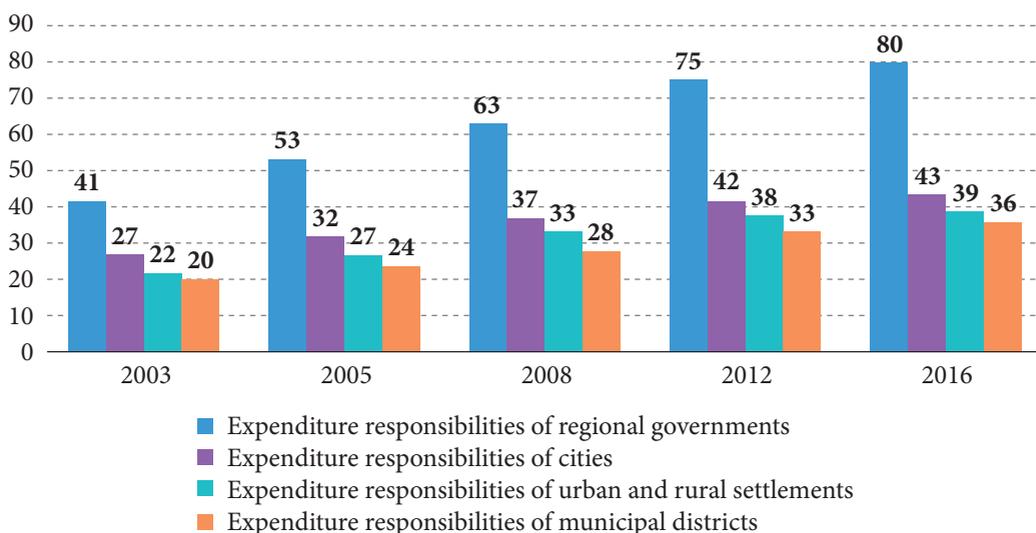
¹² Later on Irkutsk oblast (2006) and Zabaykalsky Krai (2007) became part of this enlargement reform

New Articles 56 and 61 of the Budget Code fixed the shares of federal taxes that regional and local budgets retained. In addition, the policy of natural resource rents concentration in the federal budget continued. In 2003, the regional share of mineral tax (gas) was reduced from 20% to 0%, in 2003–2004, the regional share of mineral tax (oil) fell from 20% to 14%, and then to 5%. These measures particularly hit Russia's oil and gas regions, which traditionally were donor regions (some of them lost this status either in this period or later with the further centralization of the mineral tax and due to other changes in the tax system). In 2005, the municipal shares of the profit tax and corporate property tax fell sharply (from 8% to 0% and from 50% to 0%, respectively).

We can conclude that in 2003–2005 municipalities were the party most affected by the changes in the tax system, while the regions did not yet become completely dependent on the federal center – however, the share of intergovernmental transfers grew to 15% (see Figure 4) and the share of subnational revenues in consolidated budget revenues fell from almost 40% to 32% (see Figure 3). Nevertheless, due to the abolition of the 50/50 norm, the economic foundations for equal interaction between the federal government and the regions were destroyed, which subsequently (especially during the crisis of 2008–2009) led to a significant increase in the dependence of regional budgets on federal transfers and other assistance. Following the adoption of Federal Law 131 and the significant amendments to Federal Law 184, the federal center forced regions and municipalities to finance and execute the responsibilities specified in these laws as a priority (see the increase of these responsibilities in Figure 1). This trend was accompanied by an increase in the number of regulations and mandatory requirements of the sectoral legislation, which, being unfunded mandates, also became a burden for regional and local budgets.

Figure 1

Expenditure responsibilities of subnational governments in Russia in 2003–2016



Source: Federal Laws 131 and 184

Results of this stage

After passing this crossroad, the mechanism of transformation of intergovernmental relations fundamentally changed. Before 2003, changing the fiscal system and introducing political innovations that affected subnational governments required a compromise among the three principal actors (federal government, regions and legislative power). On the contrary, after 2005, the federal executive and legislative bodies began to represent a monolithic block, while the role of the regions significantly decreased; therefore, the number of “veto” players fell to one. Almost all further transformations of intergovernmental fiscal relations took place without regards to the opinion of regions and municipalities and were an example of top-down policy.

Pervasive centralization: Development of intergovernmental relations since 2005

Since 2005, more than a decade of the further development of Russian federalism has passed. It is possible to distinguish particular decisions on changing budgets and tax legislation, accompanied by the implementation of government programs, as well as certain shifts in the political and administrative aspects of intergovernmental relations. All of these various decisions have occurred sequentially or simultaneously, but their vector was unidirectional, with the predominance of centralization for the sake of the declared stability of public finance and retaining political control over the lower levels of government.

Under the new conditions, issues regarding the distribution of powers, revenue sources, allocation of transfers, and the creation of incentives for the growth of tax potential receive a different institutional background, with the increasing authoritarian tendencies and dominating “power vertical” that assigns control functions to the federal government, which transfers major expenditure responsibilities to the lower levels of government.

Economic incentives have lost their importance in comparison with political incentives during this period since taking into account the opinion of voters becomes much less important for the governor than the attitude of those who appointed him to this post. Accordingly, regions and municipalities have a strong dependence on transfers or newly emerged unfunded mandates.

Meanwhile, as rightly noted by Enikolopov et al. (2002, p. 9), in such a huge country with heterogeneous regions, it is a combination of economic decentralization and limited political centralization that can induce the correct incentives for increasing the tax potential and economic development of the regions.

Political and administrative aspects

By the beginning of this latest period, the federal government successfully created the well-functioning “power vertical.”¹³ Further political centralization (or preservation of the status quo) has taken various forms, including some quasi-decentralization steps such as the further increase in the number of subna-

¹³ See Gel'man & Ryzhenkov (2011) for an extensive discussion of the “power vertical” and subnational governance in the mid-2000s.

tional expenditure responsibilities regulated from the center. The federal government adopted a number of unilateral decisions on the “monetization of benefits”, the (unsuccessful) implementation of the administrative reform, while the subnational authorities acquired the role of “responsible executors” of certain powers, financed and controlled by the federal center (Gaidar Institute, 2006).

The year 2005 became the point of the final reverse to centralization: the law on the actual abolition of the regional governors’ elections came into force, and a series of appointments under the new scheme was carried out. There was a significant change in the composition of the governors’ corps – “old” governors continued to be replaced by the representatives of the federal center in the most powerful regions (Moscow, Sverdlovsk, Samara and Chelyabinsk oblasts) in the period 2007–2010.

The political reform proclaimed in 2011 was aimed at returning the competition to Russian politics by resuming the governors’ elections, stimulating the emergence of new parties and thereby expanding the representation in government. As part of this reform, there was a return of the governors’ elections in 2012. Still, these elections were of a substantially different order – without real political competition and with the use of so-called municipal filters, which meant the need to support a candidate with 5–10 percent of deputies of representative bodies of municipalities and (or) elected heads of municipalities of a respective region (Federal Law 40 of 2.05.2012). The municipal filter proved to be a convenient tool for manipulation and control for incumbent governors and the ruling party. By 2013, legislative assemblies had already received the right to decide whether to hold governors’ elections or not.¹⁴ This political transformation is an example of a non-linear type of centralization – 7 years after the sudden abolition of governors’ elections they were returned with significant restrictions. Therefore, this new equilibrium was much more favorable for the federal center than the initial state of direct and free governors’ elections. Moreover, since 2015 a new tendency has begun – under various pretexts, the president has started to regularly remove governors from their office, thus undermining the whole idea of the return of direct elections.

In 2014, the mixed electoral procedure for electing the State Duma was returned, but in practice, it even further reduced the chances for oppositional parties to get into parliament since the ruling party with its huge financial and administrative resources and strong regional branches easily won the absolute majority of single-member districts in 2016 elections. The amendments to Federal Law 131 (by Federal Law 136 of 27.05.2014) introduced the new types of municipalities – urban districts with an intra-urban division and intra-urban areas, which can presumably undermine the independence of the major cities. However, until now, these new districts have only emerged in three large cities – Chelyabinsk, Samara, and Makhachkala – but the risk of changing the status of other large cities still exists.

In 2014, there were new amendments to the Constitution concerning the formation of the Federation Council (Federal Constitutional Law 2 of 05.02.2014, and Federal Constitutional Law 11 of 21.07.2014) that introduced the so-called pre-

¹⁴ Several North-Caucasian republics (Dagestan, Ingushetia, North Ossetia, Karachay-Cherkessia) as well as Khanty-Mansi and Yamalo-Nenets autonomous okrugs replaced the direct governors’ elections by appointing them through the regional parliaments.

sidential quota of senators (no more than 10%), appointed and dismissed by the president. Although these amendments were discussed much less than previous changes that extended the terms of the president and the State Duma, they contributed to the further reduction of the role and representation of regions in the Federal Assembly.

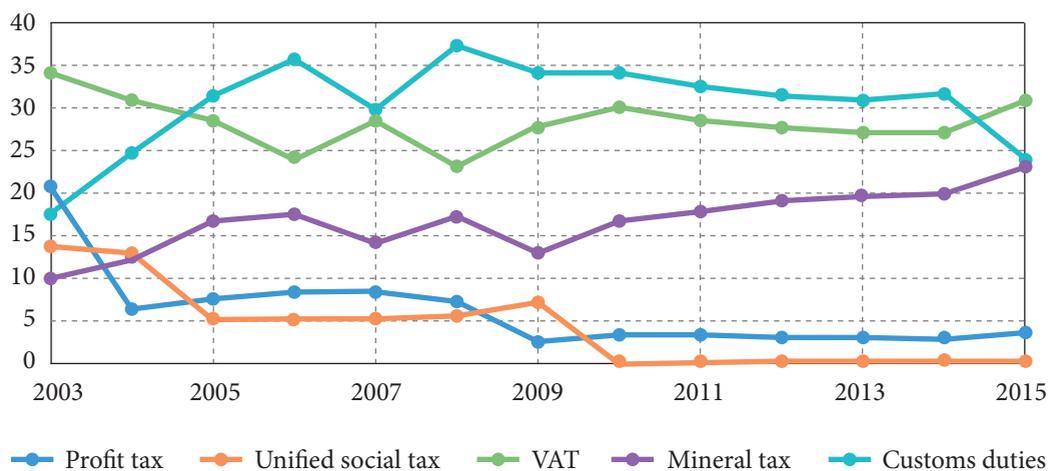
Economic and fiscal aspects

During the mid-late 2000s, the federal government adopted a number of government and state programs related to the economic aspects of intergovernmental relations. They included, inter alia, the Program of Fiscal Federalism Development in 2002–2005, the Concept for Increasing the Efficiency of Intergovernmental Relations and Improving Subnational Finance Management in 2006–2008, the Concept of Intergovernmental Relations and Organization of the Budgetary Process in the Regions and municipalities for the period until 2013, the Government Program for Improving the Efficiency of Budget Expenditures for the period until 2012. The crucial issue of these programs and concepts is that they constantly stressed the need to implement a clear and stable delimitation of tax and expenditure responsibilities between different levels of government. However, this goal, as well as many other ambitious aims of these programs, have not been achieved by now. The list of such aims included the necessity to strengthen regional fiscal autonomy, create incentives for increasing subnational revenues, improve the efficiency of subnational budget expenditures, and increase the transparency of regional and local budgets. The detailed analysis of these programs and results of their implementation can be found in Oding, Savulkin & Yushkov (2016).

The fiscal innovations of the mid-2000s described in the previous paragraph significantly affected the structure of the Russian federal budget: oil and gas rents now constitute more than 50% of federal budget revenues, a significant share of which belongs to the mineral tax (~23% in 2015), and customs duties (~25% in 2015) (see Figure 2).

Figure 2

Structure of federal budget revenues, 2003–2015, %



Source: Russian Ministry of Finance and Federal Treasury.

In the middle of the 2000s, the structure of federal budget revenues, which was relatively diversified and corresponded to good international practices at the beginning of the 2000s, changed drastically. It became precarious for the stability and sustainability of the budget system in the face of worsening energy prices on global markets since the regions depend on federal transfers, which could potentially decrease in the event of price shocks.

The structure of regional revenues was quite stable during this period – personal income tax and enterprise profit tax have remained the primary taxes for regional budgets comprising more than 70% of revenues. However, after 2009 the regional share of mineral tax (oil) decreased from 5% to 0%, which again affected several resource-rich donor regions. This tax centralization trend has continued recently as from 2017 the maximum regional rate of the enterprise profit tax has decreased from 18% to 17%.

At the same time, the regional share of an excise tax on gasoline dropped from 88% to 61.7% in 2017 and 57.4% in 2018. Municipalities during this period have become much more dependent on transfers from the higher levels of government, while their own revenues had dropped to 40% of total revenues by 2015. The main reason was again the allocation of tax revenues – in 2009, the municipal share of simplified tax for individual entrepreneurs decreased from 10% to 0% (100% of these tax collections were assigned to the regional budget); before 2012, 70% of personal income tax collections went to regional budgets with 30% to municipal, in 2012–2013 this share changed to 80%/20%, and after 2013 it became 85%/15%.

As a result of these changes, the (almost) equal allocation of revenues between the federal budget and consolidated regional budgets which had existed in the early 2000s had turned into a proportion of 70/30 in favor of the federal center by 2012 (see Figure 3). The concentration of revenues in the federal budget throughout the 2000–2010s was another example of linear centralization.

Figure 3

Share of subnational revenues in consolidated budget of the Russian Federation (excl. extrabudgetary funds and IGT), %

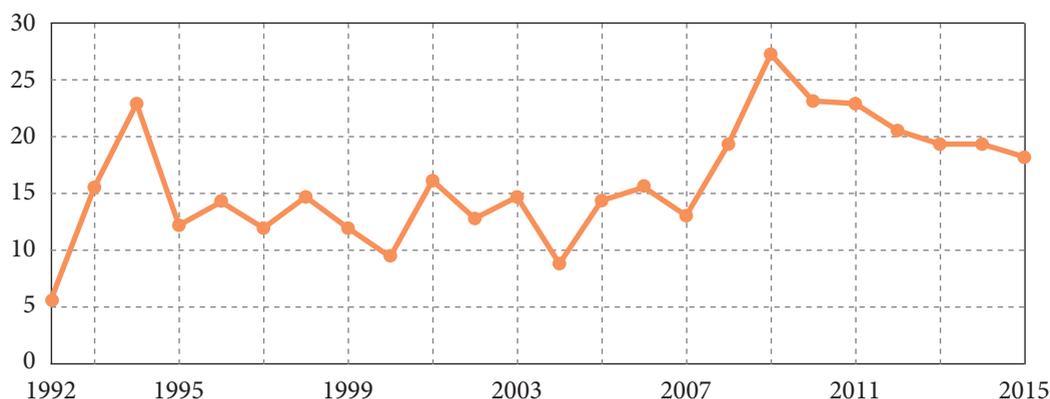


Source: Russian Ministry of Finance and Federal Treasury.

The share of intergovernmental transfers in total revenues of consolidated regional budgets was less than 10% in 2004, but by 2008 it had increased to 19.5% (see Figure 4). During the financial and economic crisis of 2009–2010, in order to maintain the stability of subnational budgets, the federal center increased the volume of financial support to the regions to 27.3% of the revenues of their consolidated budgets. In subsequent years, the share of transfers was somewhat reduced (to 23.1% in 2010–2011, 20.8% in 2012 and 19.4% in 2013–2014), but it remained at almost a fifth of the subnational budget revenues. The dynamics of transfers represents a non-linear type of centralization. As we can see from the figure, the average level of transfers in consolidated regional budget revenues was about 15% in 1996–2006, but after the shock the equilibrium share shifted towards 19–20%, which represents the increased dependence of regions on transfers.

Figure 4

Share of intergovernmental transfers in consolidated regional budget revenues, %



Source: Russian Ministry of Finance and Federal Treasury.

After 2005, the federal government attempted to increase the transparency of intergovernmental fiscal relations. In 2005, the allocation principle of equalization transfers from the Federal Fund for Financial Support of Regions (FFSR) used in 2001–2004 changed. Other transfers (subsidies and subventions) started to be allocated from the Federal Fund for Co-Financing of Expenditures and Federal Compensation Fund according to the formulas approved by government resolutions. After 2008, the size of the equalization fund was determined based on the minimal fiscal capacity requirement that all regions should meet after equalization (see additional discussion on intergovernmental design in the 2000s in De Silva et al. (2009)). However, recent changes demonstrate that the transparency and predictability of intergovernmental transfers are exposed to significant risk. Federal Law 104 of 7.05.2013 abolished the Federal Fund for the Co-Financing of Expenditures and the Federal Compensation Fund, while the methodology for the allocation of equalization transfers changed significantly in 2016. Despite some positive transformations, the distinctive characteristic of the Russian-style inter-

governmental design is that the significant share of transfers is allocated without any clear economic foundation and is not formula-based.¹⁵

Additional fiscal measures implemented by the federal government since 2005 that influenced subnational governments included the adoption of the three-year federal budget¹⁶ (which was the implementation of the medium-term budget framework) and the use of program-based budgeting, the introduction of the concept of a consolidated group of taxpayers (Federal Law 321 of 16.11.2011), the implementation of the registers of expenditure responsibilities at regional and local levels, and other novelties. All of these were mostly technical and did not change the ongoing centralization trend; thus, we do not consider them in detail in this article.

Results of this stage

The results of this stage include the new equilibrium of intergovernmental design, which assumes the centralization of power and financial resources at the top level of government, with simultaneous decentralization of expenditure responsibilities to the regional level. The regions try to copy this design and implement it within themselves, obliging municipalities to conduct certain policies without having enough of their own revenue sources. At the heart of the current system of intergovernmental relations is the desire of the federal government to exercise control over subnational governments and reduce potential risks, thereby creating a stable asymmetric federation. However, it does not eliminate the possibility of the emergence of new risks and imbalances in the entire system due to a decrease in the quantity and quality of public services, a lack of incentives for increasing the tax potential and growth, and preserving the inefficient structure of the economy in regions and municipalities.

Conclusion

Since the beginning of the 1990s, Russian federalism has undergone three major periods in its development and several dramatic shifts from one trend to another. The first period (1991 – early 2000s) was a synchronous pendulum motion of political and economic (de)centralization – from the Soviet centralized system through spontaneous and radical decentralization and the subsequent formalization of an institutional environment to recentralization tendencies from the end of the 1990s. The second period was a critical crossroad (2003–2005) when decision-makers considered several options for the design of intergovernmental relations. However, ultimately, it became a turning point back to the centralized state. The federal government severely undermined the autonomy of regions as well as the political and economic foundations of local self-government. The third period (2005-present) has become a continuation of the pervasive centralization started after passing the critical crossroad and a further step against the funda-

¹⁵ A detailed discussion on the use of intergovernmental transfers at the latest stage of fiscal federalism development can be found in Yushkov, Oding & Savulkin (2016).

¹⁶ During the crises of 2009 and 2015, the federal government adopted the one-year budgets. However, in both cases, it returned to the three-year budget planning almost straight away (in 2011 and 2016).

mental principles of federalism. The detailed analysis of the political economy of intergovernmental relations in Russia shows that since the early 2000s the trend towards centralization has assumed two distinct types:

- *Linear centralization* – straightforward and systematic activities of the federal government to centralize a particular function or responsibility previously attributed to subnational governments; consolidation takes place until the federal center reaches its desired outcome, which then remains at its steady-state level for a long time. Examples of this type include the centralization of natural resource rents (in particular, mineral tax on oil and gas), the increase in the number of (mandatory) expenditure responsibilities of subnational governments that are not matched with sufficient financial resources, and the simultaneous decrease of subnational tax autonomy and the self-generated revenues of regions and municipalities.
- *Non-linear (stepwise) centralization* – usually an abrupt centralizing response by the federal government to exogenous shocks. After the recovery from the shock, the federal center can take quasi-decentralization measures, but the new equilibrium is more centralized and less beneficial for subnational governments than the initial state. One example of this type is the abolition of direct regional governors' elections in 2004 in response to terrorist threats (at least, the federal government articulated this reason) and the subsequent return of the elections 8 years later with significant restrictions and filters. Another example is the sharp increase of the dependence of regional governments on federal transfers in 2009 (the share of transfers in regional revenues was up to 27% at the peak of crisis) with the subsequent decrease to 20%, which is much higher than the initial steady state (10–15%), but with the worsened structure of transfers (a higher share of conditional grants, which imply higher accountability to the federal center).

The decisions and actions of the federal center since the early 2000s have led to a decrease in the independence of regions and, in particular, municipalities. The design of intergovernmental relations is fundamentally different from the initially declared and formalized intentions of the Russian government to build a federal state that creates conditions for the improvement of regional tax potential and the efficient provision of public services. As a result, currently the Russian Federation can be considered as either a vertically asymmetric federation or a de-facto unitary state.

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