February 22, 2019

Budget surplus saved for the future

2018 Budget results for Russian regions

- **Budget surplus "saved for a rainy day."** Russian regions have put the majority of the 2018 budget surplus, which amounted to RUB 492 bln, toward savings for the future. The regions used only one fifth of the budget surplus to reduce debt, leaving the remainder to finance budget deficits for years to come.

- **Property taxes have again made the biggest contribution to the growth of income.** This time, however, the growth in commodity prices is the reason, not changes in legislation. Property tax revenues increased by RUB 576 bln. This increase accounted for half of the growth in the regions' tax and non-tax revenues (TNTR) and 38% of the growth in total revenues.

- **Temporary changes in legislation helped increase the revenue of regional budgets again in 2018.** Last year, some regions did not retain the canceled federal property tax exemption and received a one-time increase in income from this tax.

- **Transfers have grown on non-target transfers.** An increase in non-target transfers provieded two-thirds of the record growth in transfers (+22% at year-end). In General, this growth corresponds to the policy of the Ministry of Finance to redistribute part of the income tax. Regions redistributed transfers further; the share of general transfers also increased in the regional expense structure.

- **Regional budget expenses grew more slowly than reveneue, while investments and interest expenses reduced.** The growth in budget revenue (RUB 1 trln in 2018) was formed largely in the following sections: education, social policy, the public road system, housing and utilities, and general transfers. Investments reduced by 4% and interest expenses by 18%.

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The total budget has resulted in a surplus

For more on this topic, see ACRA's research from February 22, 2018, "[Corporate sector to drive surpluses of regional budgets, and federal center to save overleveraged regions](#)."

For the first time throughout our analysis (since 2007), the regions' total budget has resulted in a surplus of RUB 492 bln. To compare, 2017 resulted in a deficit of RUB 15.5 bln while 2016 saw a deficit of RUB 2.4 bln. In 2018, the combination of macroeconomic market conditions and management decisions at the government level created a positive environment for budget fulfillment.

70 regions finished the year with a surplus compared to only 45 regions in 2017. Moreover, the total surplus of regions finishing the year with positive results amounted to RUB 551 bln, which is 3.6 times larger than in 2017. The regions' total deficit amounted to RUB 59 bln, which is almost 3 times lower than in 2017.

The regions can be broken down into the following: 27 regions were able to fulfill their budgets resulting in a surplus as opposed to a deficit; 11 regions reduced their deficit; only 3 regions saw a growth in deficit (the Moscow Region, Khabarovsk Krai, and the Sakhalin Region). The budgets of the Altai Republic and the Amur Region resulted in a deficit whereas last year they saw a surplus.

Table 1. Twenty-seven regions achieved a surplus in 2018

	Deficit, 2017	Surplus, 2018		Deficit, 2017	Surplus, 2018
Kostroma Region	-1 971	1 895	Republic of North Ossetia	-231	380
Oryol Region	-2 246	326	Orenburg Region	-53	11 719
Tula Region	-2 576	3 726	Ulyanovsk Region	-2 086	993
Republic of Karelia	-2 425	4 192	Kurgan Region	-1 705	164
Arkhangelsk Region	-839	3 175	Sverdlovsk Region	-3 421	8 084
Kaliningrad Region	-2 951	1 920	Tyumen Region	-1 481	33 575
Leningrad Region	-7 961	13 206	Khanty-Mansiysk Autonomous Okrug	-17 189	36 680
Murmansk Region	-237	22	Irkutsk Region	-184	13 993
Saint Petersburg	-43 439	10 114	Omsk Region	-753	2 425
Volgograd Region	-1 184	2 813	Republic of Khakasia	-1 874	2 732
Sevastopol	-2 590	3 836	Zabaykalsky Krai	-2 289	795
Republic of Crimea	-930	304	Republic of Sakha (Yakutia)	-9 080	10 222
Republic of Adygea	-643	387	Chukotka Autonomous Okrug	-1 122	423
Kabardino-Balkar Republic	-2 690	1 753			

Sources: Ministry of Finance, ACRA's calculations

Budget surplus "saved for a rainy day"

Although regions spent part of the 2018 budget surplus to reduce debt (RUB 109 bln), they put most of the surplus into reserves for future use. The regions will be able to use these funds in coming years to offset future deficits. Despite the fact that it was possible to repay most of the debt with the surplus achieved, some regions for objective reasons did not do this because it would have been economically impractical to repay long-term, cheap debt.

Last year, 67 regions formed reserves amounting to RUB 349 bln (not counting Moscow), which is significantly higher than in 2017 when 41 regions accrued RUB 90 bln for reserves (again, not counting Moscow).

For more on this topic, see ACRA's research from December 17, 2018, "For some – a trade war, for others – profits: Ferrous metals are resisting falling prices, maintaining the creditworthiness of the industry," and January 15, 2019, "OPEC-led supply pact slows down launch of new oilfields in Russia."

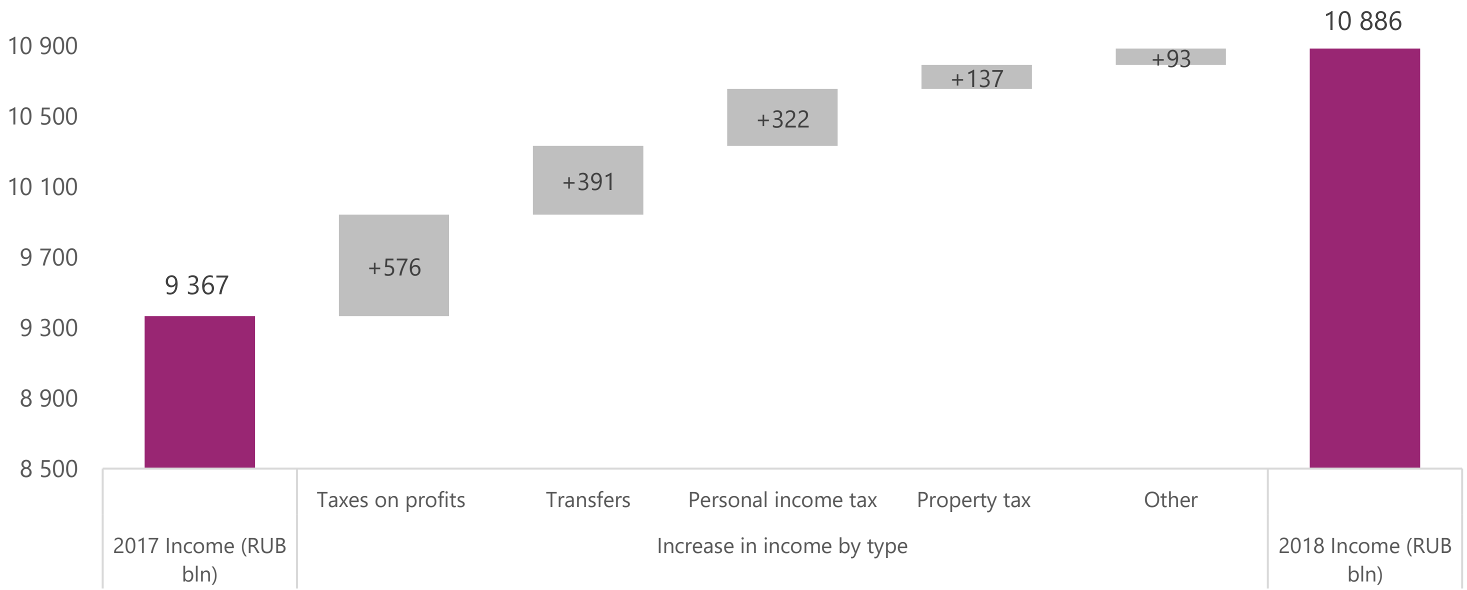
Due to the high growth rate of tax revenues, as previously mentioned, most regions in 2018 were able to ensure the TNTR growth rate at a level above the inflation rate (4.3%). This allows the regions to count on the maturity date extension of restructured budget loans from 7 years to 12 years, provided that the TNTR growth rate will again be ahead of inflation by the end of 2019. Only seven regions failed to meet this condition and will not be able to prolong the repayment (if they participate in the restructuring).

The projected decline in ruble commodity prices and the products of their primary processing will limit the ability of the regions to further increase the tax on profits. In addition, starting in 2019, the movable property of organizations will no longer be taxed resulting in a decrease in income from property tax. Partial compensation of the regions' tax revenues is provided — these are additional transfers (which, however, do not contribute to TNTR growth), as well as an increase in the standard of excise taxes on alcohol sales. Given the fact that the share of excise taxes in the regions' income is small, the growth of deductions will not lead to a significant increase in TNTR. As a result, in 2019, the growth rate of tax revenues will slow down and regions will need to maintain social obligations and finance national projects. In such circumstances, the regions that have saved significant reserves will be able to maintain the current financial performance, and the rest could once again increase the debt burden.

Income has increased again due to taxes on profits

Taxes on profits provided half of the growth in TNTR (RUB 576 bln of RUB 1.1 trln) and 38% of the total income growth (+1.5 trln compared to last year). Personal income tax (21%), non-target transfers (18%), and property tax (9%) also made significant contributions to the growth of total income.

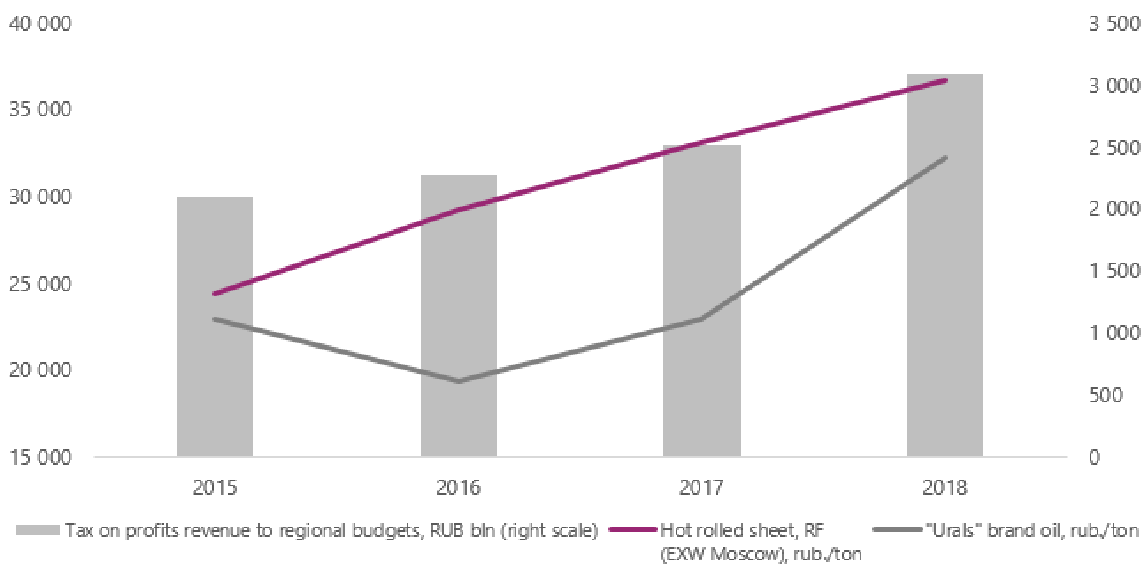
Figure 1. The increase in taxes on profits provided more than a third of regional budget revenue growth



Sources: Ministry of Finance, ACRA's calculations

If taxes on profits increased in 2017 mainly due to temporary changes in legislation, then one of the main reasons for the growth in 2018 was high ruble commodity prices.

Figure 2. The growth of ruble commodity prices and commodity markets caused the increase in taxes on profits



Sources: Ministry of Finance, ACRA's calculations

Income tax revenues have grown by over one-third in 12 regions that depend heavily on the mining sector industries.

Table 2. Profit tax revenue trends

	Max. growth		Max. decline
Khanty-Mansi Autonomous Okrug	169%	Khabarovsk Krai	-5%
Republic of Karelia	102%	Zabaikalsky Krai	-6%
Republic of Sakha (Yakutia)	75%	Kurgan Region	-6%
Tyumen Region	64%	Omsk Region	-8%
Vologda Oblast	61%	Kamchatka Krai	-9%
Republic of Bashkortostan	56%	Jewish Autonomous Oblast	-10%
Leningrad Region	52%	Amur Region	-11%
Tomsk Region	47%	Kabardino-Balkar Republic	-13%
Yamalo-Nenets Autonomous Okrug	46%	Karachay-Cherkess Republic	-13%
Lipetsk Region	45%	Sakhalin Region	-15%
Orenburg Region	41%	Republic of Tyva	-36%
Belgorod Region	34%	Mari El Republic	-40%
Kemerovo Region	33%	Republic of Crimea	-65%

Sources: Ministry of Finance, ACRA's calculations

Regional economies that are less dependent on oil production, metals or coal mining industries showed a somewhat lower income tax revenue growth, except the Sakhalin Region where the legislative changes drove such revenues down.

Property taxes have increased briefly

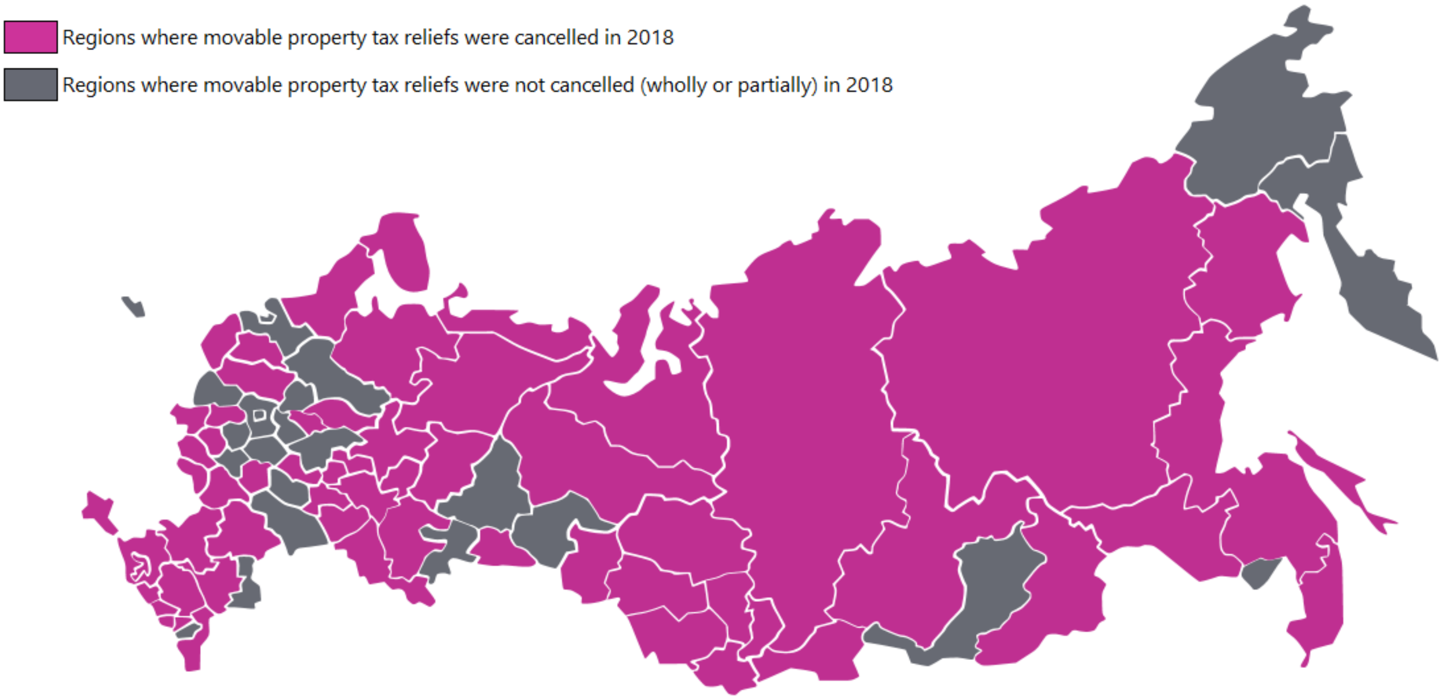
In 2018, the federal corporate movable property tax relief was cancelled in 61 out of 85 regions, where the tax rate was set at 1.1%.

In 2018, the regions' budget revenues also grew on temporary legislative changes. Property taxes contributed a 12% share to the TNTR growth.

In some regions, total corporate property tax revenues grew by 15% on temporary changes in the corporate movable property tax.

The average growth in the corporate movable property tax revenues amounted to 16% in those regions where the corporate movable property tax relief was not cancelled and 11% in other regions. In 2019, the corporate movable property tax will no longer be charged, and relevant tax revenues will stop growing.

Figure 3. Movable property tax reliefs by region



Source: Consultant Plus law assistance system

Another one-third of the TNTR growth (or 21% of the total revenue growth) was contributed by the personal income tax (PIT), which showed a 13% growth y-o-y following the 10.8% increase in nominal wages and salaries in 2018 (according to Rosstat).

Transfers have grown on non-target transfers

In 2018, budget transfers granted to regions demonstrated a record high growth rate (+22%), to which non-target transfers contributed two thirds. Note that, in its economic essence, a non-target transfer is not a targeted cash inflow.

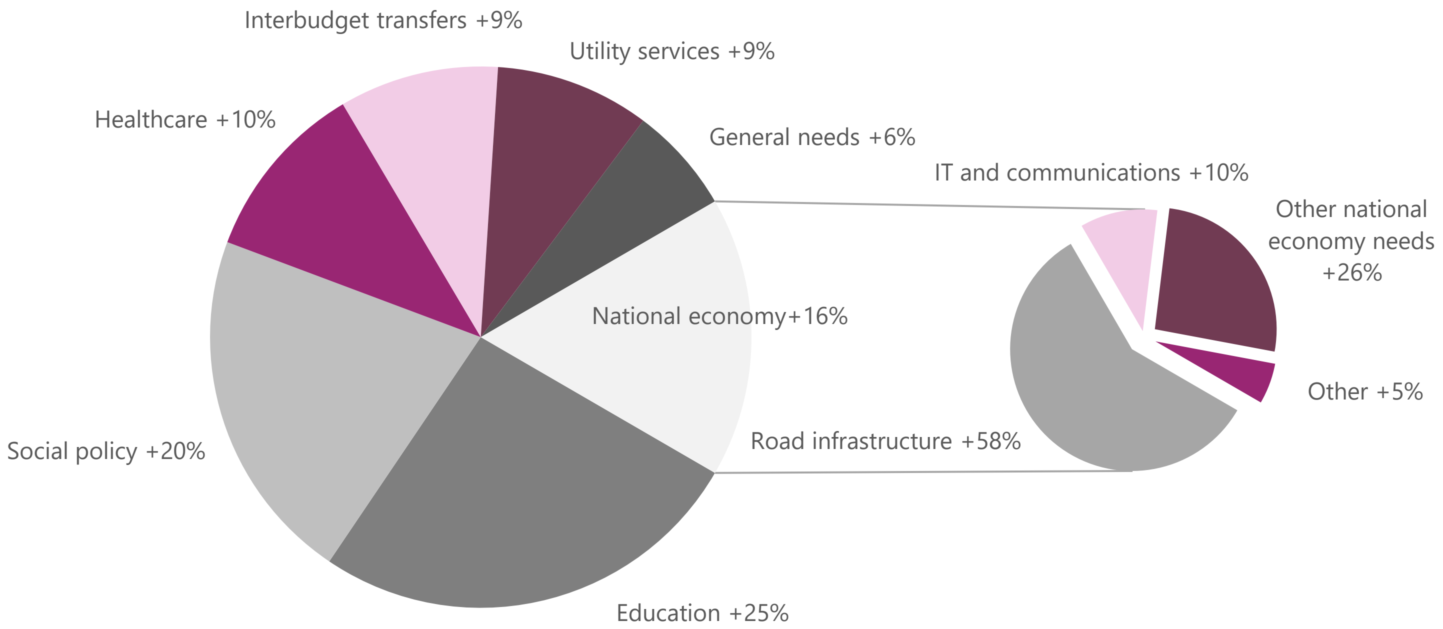
Half of the transfers (RUB 136 bln) are non-target transfers to support budget balance, and another 22% (RUB 60 bln) are aimed to compensate labor costs. Non-target transfers to promote tax potential amounted to RUB 31 bln (11% of the total increase in non-target transfers).

The increase in non-target transfers is in line with the policies of the Ministry of Finance of Russia aimed at partial redistribution of income tax: it was contemplated that some portion of the temporarily withdrawn tax would be reallocated to regional budgets in the form of non-target transfers.

Investments and interest expenses have decreased

Regional budget expenditures grew slower than revenues, while investments have shrunk. The increase in the total budget expenditures amounted to 11%, although budget revenues grew by 16%. In 2018, the budget expenditures grew by RUB 1 trln to cover the needs of public education, social policy, the public road system, housing and utilities, and general transfers.

Figure 4. Growth in regional budget expenditures in 2018



Sources: Ministry of Finance, ACRA's calculations

A negative sign is that in 2018, regions have reduced slightly (by RUB 36 bln) their capital investments into state/municipal properties. The amount of capital investments into state/municipal properties is not a complete reflection of regional capital expenditures but still, it includes a major part of them. This reduction is a result of the completion of some federal programs (for example, the rehousing program[1], 2018 FIFA World Cup), however, it indicates that the share of current expenses has been growing.

For the first time since 2013, the debt service costs have decreased below RUB 100 bln to RUB 90 bln. The decrease in interest expenses is driven by the obligation taken by the regions under the budget loan restructuring agreements to borrow bank loans at rates no higher than the CBR's key rate + 1%.

[1] The program may be reactivated in 2019.