

SOCIO-ECONOMIC DEVELOPMENT STRATEGY

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Passive Behavior of the Government. Budget Problems are Aggravating in the Regions



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Abstract. Despite a number of reforms, the current multi-level budgetary system does not fully correspond to the development strategy of the country and its regions. *Still the Russian Government has not taken effective measures to address the main structural contradiction of the budgetary system, based on the non-adequate distribution of revenue and expenditure responsibilities, manifested in the sharp decline in the revenue base of territorial budgets during the 2009 global financial crisis. However, the crisis effects have not been analyzed and the conclusions have not been made.* The Ministry of Finance of the Russian Federation tried to solve the problem of territorial budgets imbalance not by enhancing existing mechanisms of revenue distribution at the regional level, but by granting large-scale loans to be repaid after 2012. Despite it, due to the sharp rise in the social burden¹, the deficit and the debt load enlarged and resulted in the budget crisis in the regions. The experts of the Higher School of Economics state that 20 RF subjects, having the level of public debt above 80%, had been actually in default² by the end of 2014. Instead of finding ways out of the fiscal crisis, the Russian authorities gradually lose overall control over the processes of regional development. The mechanisms of federal target programs work poorly and the RF subjects have to finance program activities³. In fact, the management of territorial development is reduced to the transfer of financial

¹ After the adoption of the Presidential decrees of May 7, 2012 the social load has been redistributed between levels of the budget system: the regions' share in the social sector financing has increased from 46% in 2012 to 51% in 2014

² *Vysshaya shkola ekonomiki: 20 rossiiskikh regionov fakticheski v defolte* [Higher School of Economics: 20 Russian are Regions Actually in Default]. Available at: <http://www.finmarket.ru/news/4015638>

³ In 2008–2014 the amount of subsidies to territorial budgets to co-finance the federal target programs decreased by 6 times – from 123.9 billion rubles to 20.3 billion rubles.

resources from the federal budget to the regions and the Ministry of Finance of the Russian Federation regulating interbudgetary relations has, in fact, become the only real institute of regional policy. But the interbudgetary policy of the Ministry of Finance does not gain visible economic returns: in 2006–2014 the amount of repayable financial assistance to the regional budgets increased from 0.6 to 1.5 trillion rubles, and the number of self-sufficient territories decreased from 20 to 11. The worsening of socio-economic problems is accompanied by a difficult international environment, adverse effects of external sanctions against Russia and falling oil prices. Already in 2014 the losses from the sanctions amounted to 40 billion U.S. dollars, from the decline in oil prices 100 billion U.S. dollars⁴. However, the federal budget for 2015 was approved without taking into account these factors. It demonstrates the inability of the Russian Government to accurately assess the situation and forecast events even in the short term. Due to forced significant amendments to the federal budget in April 2015, *its deficit was increased seven-fold, from 0.4 to 2.7 trillion rubles*. Surely, this imbalance of the country's budget will seriously complicate the implementation of local budgets. In the new version of the federal budget transfers to regions cut by 72 billion rubles, or by 10.5%. The anti-crisis plan of the Russian Federation Government aimed at cutting budget spending provides not grant financial support to the regions, but allocation of budgetary loans in the amount of 160 billion rubles, which will be returned to the The Federal Treasury. These funds will be enough to repay only 15% of the accumulated commercial debt of regional budgets. *Such a short-sighted budgetary policy of the central authorities deprives the regions of any hope of solving the problem of rising public debt*. The crisis, greatly affecting the regions with metallurgical specialization, has highlighted the limits of countercyclical potential of fiscal policy. The lack of budget risk management involves deep drop in tax revenues, a major revenue source of regional budgets. Another negative consequence is that the Vologda Oblast, the Lipetsk Oblast, the Chelyabinsk Oblast and the Kemerovo Oblast have lost the status of donor regions. The article presents the results of the research in the problems of budgetary provision of the Vologda Oblast, the Lipetsk Oblast and the Chelyabinsk Oblast, carried out by ISEDT RAS. The leading domestic corporations of ferrous metallurgy are located in these areas. The work evaluates the state of regional budgets, debt policy and interaction with the federal budget as of year-end 2014. The main accent is made on the analysis of relations between metallurgical corporations and territorial budgets. Despite the fact that the metallurgy-oriented regions are characterized by significant structural features, the estimates vary greatly in the territorial context. However, we can make a general conclusion that in these regions one can observe *the growing problems connected with the receipt of tax payments from the key revenue generating industry since 2009*. It entails a number of other negative factors of the regional budget systems functioning. *Due to highly inefficient economic policies pursued by the central government in respect of the largest taxpayers, the regional authorities have completely lost the ability to regulate their economic activities*.

Key words: metallurgical corporation, regional budgets, income tax, public debt, public management efficiency.

⁴ Ershov M., Tanasova A., Tatusov V., Lupandina O. Finansovaya sfera: o nekotorykh sobyitiyakh i itogakh 2014 goda [Financial Sector: on Some Events and Results of 2014]. *Rossiiskii ekonomicheskii zhurnal* [Russian Economic Journal], 2015, no.1, pp. 100-109.

In 2014 the budgets of metallurgy-oriented regions were executed in the conditions of aggravated socio-economic problems of regional development. The growth of gross regional product (GRP) was the lowest for the last fifteen years (excluding 2009). The Vologda region had the lowest average annual growth rate of the economy, amounting to 0.3% (*tab. 1*).

The decrease in investment activity is one of the main factors for the deceleration of economic growth. The decline of investment in fixed assets, which amounted to 54% compared to the pre-crisis level, was recorded in the Vologda Oblast in connection with the completion of major investment projects and the reduction of investment programs of the energy companies. The negative trend in investment growth was characteristic of other regions, but the decline was not as severe as in the Vologda Oblast (*tab. 2*).

The decline in investment activity in these regions was caused by sharp deterioration of financial results of the economic entities due to lower demand for industrial products, insufficient working capital necessary for the implementation of mutual settlements and payments (*tab. 3*).

In 2014, even without adjustments for inflation, the net profit of enterprises in the Lipetsk Oblast and the Chelyabinsk Oblast accounted for 35%–60% of the 2008 level. The financial results of the Vologda Oblast economy were characterized by a significant loss, which amounted to 34 billion rubles, i.e. 60% of the territorial budget's revenue.

Such serious yield decline in the economies of metallurgy-oriented regions occurred against the backdrop of significant profit growth in all the constituent entities of the Russian Federation. Surely, the metallurgical companies had a decisive influence on the formation of financial

Table 1. Index of physical volume of GRP in Russia in 2007–2014, % to the previous year

Subject	2000–2011	2011	2012	2013	2014	2012–2014
Lipetsk Oblast	105.0	104.8	101.8	103.4	101.0	102.1
Chelyabinsk Oblast	104.9	105.3	102.4	101.5	102.2	102.0
Vologda Oblast	103.1	106.9	104.8	95.5	100.5	100.3
Russian Federation	105.3	104.3	103.4	101.3	100.6	101.8

Sources: data of the Federal State Statistics Service of the Russian Federation; the author's calculations.

Table 2. Index of physical volume of investment into fixed capital in Russia in 2008–2014, % to the previous year

Subject	2008	2009	2010	2011	2012	2013	2014	2014 to 2008, %
Lipetsk Oblast	118.4	91.9	116.5	102.8	78.0	103.5	105.0	93.3
Chelyabinsk Oblast	113.8	75.9	99.2	107.6	100.1	103.2	101.8	85.2
Vologda Oblast	85.9	71.1	116.1	149.4	120.7	38.7	80.5	46.4
Russian Federation	109.5	86.5	106.3	110.8	106.8	100.8	97.3	106.7

Sources: data of the Federal State Statistics Service of the Russian Federation; the author's calculations.

Table 3. Net financial result of the organizations' activity (profit +, loss -) in Russia in 2008–2014, billion rubles

Subject	2008	2009	2010	2011	2012	2013	2014	2014 to 2008, %
Lipetsk Oblast	116.9	32.4	45.6	44.1	36.5	3.7	40.6	34.7
- metallurgy	103.9	24.9	38.4	39.5	28.1	-10.9	30.2	29.1
Chelyabinsk Oblast	53.8	43.7	67.3	28.6	53.2	-34.4	32.0	59.4
- metallurgy	26.5	31.3	42.5	6.1	20.4	-58.0	No data	No data
Vologda Oblast	90.8	10.6	-21.6	28.6	55.2	15.4	-33.6	x
- metallurgy	55.8	5.2	-33.3	0.03	17.3	12.4	-35.5	x
Russian Federation	3801	4432	6331	7140	7825	6854	5906	155.4
- metallurgy	313	207	351	289	284	148	238	76.0

Sources: data of the Federal State Statistics Service of the Russian Federation; the author's calculations.

results of the regions under analysis. The losses of the metallurgical enterprises of the Lipetsk Oblast and the Chelyabinsk Oblast in 2013 and the Vologda Oblast in 2014 could not be compensated by any other industry. It reveals disadvantages of monofunctionality once again. The decline in consumer activity, which used to be one of the drivers of economic growth, has become a distinctive feature of recent years.

In 2014 due to accelerated inflation and counter-sanctions imposed by the Russian authorities, the real wages growth rate in the Vologda Oblast and the Lipetsk Oblast, real monetary incomes of the population in the Chelyabinsk Oblast acquired a downward trend (*tab. 4*).

The deterioration of the socio-economic situation resulted in strengthening of destructive processes in the regional budgetary systems. By the end of 2014 the metallurgy-oriented regions, like most Russian regions, could not reach the

pre-crisis volume of budgets' revenues in real terms. However if the whole country requires 6% of the sources for complete recovery of the revenue, the Lipetsk Oblast and the Chelyabinsk Oblast – 10% and the Vologda Oblast – 26% (*tab. 5*).

The slow recovery of revenue sources, even in the conditions of expanded support for metallurgy-oriented regions⁵ provided by the federal government, resulted in the accumulation of debt problems. At the same time, various aspects of the regional authorities' debt policy are non-uniform. First, the debt load of the Vologda Oblast was above 80% and close to critical (100% in the volume of own revenues of the budget). In the Lipetsk Oblast and the Chelyabinsk Oblast the debt burden increased significantly, but was significantly lower than in the Vologda Oblast: 51 and 26% of the territorial budgets' total revenue, respectively (*tab. 6*).

⁵ In 2009–2014 the amount of federal transfers to the budgets of the analyzed regions doubled compared to 2008.

Table 4. Consumer demand dynamics in Russia in 2008–2014, % to previous year

Indicators	2008	2009	2010	2011	2012	2013	2014	2014 to 2008, %
Vologda Oblast								
Real incomes of the population	100.5	103.3	108.2	100.8	110.6	105.6	101.8	134.0
Real wages	108.4	92.9	105.6	99.8	106.9	104.4	98.2	107.3
Retail trade turnover	108.5	89.4	116.3	107.6	119.7	101.7	102.0	138.9
Consumer price index	114.3	107.2	109.2	105.7	106.0	107.2	112.0	157.5
Lipetsk Oblast								
Real incomes of the population	108.8	105.4	103.0	97.8	112.0	103.8	106.4	131.3
Real wages	105.0	91.7	104.7	102.7	109.1	102.3	95.0	104.5
Retail trade turnover	117.3	100.0	106.9	109.2	107.5	107.0	104.7	140.6
Consumer price index	116.0	108.7	108.1	104.7	106.6	106.3	111.9	156.0
Chelyabinsk Oblast								
Real incomes of the population	116.1	97.0	103.1	99.1	101.8	104.6	97.2	102.6
Real wages	108.8	91.7	107.9	104.1	106.7	107.9	100.0	118.6
Retail trade turnover	122.4	93.0	100.8	101.7	105.6	104.1	99.5	104.3
Consumer price index	112.8	108.6	109.6	108.3	106.3	105.4	109.9	58.7
Russian Federation								
Real incomes of the population	103.8	101.8	105.4	101.2	105.8	104.8	99.0	119.2
Real wages	111.5	96.5	105.2	102.8	108.4	105.3	101.3	120.7
Retail trade turnover	113.5	94.9	106.5	107.1	106.3	103.9	102.5	122.5
Consumer price index	113.3	108.8	108.8	106.1	106.6	106.5	111.4	58.8
Sources: data of the Federal State Statistics Service of the Russian Federation; the author's calculations.								

Table 5. Dynamics of revenues of the RF subjects' budgets in 2008–2014, billion rubles*

Subject	2008	2009	2010	2011	2012	2013	2014	2014 to 2008, %
Lipetsk Oblast	76.0	54.3	59.1	60.3	61.8	56.8	56.4	74.2
Chelyabinsk Oblast	60.2	49.0	48.5	50.0	50.0	49.1	54.2	90.0
Vologda Oblast	159.3	122.0	141.8	143.3	145.6	139.2	142.5	89.5
Russian Federation	9300.8	8104.3	8367.4	9111.5	9120.7	8695.4	8746.6	94.0
* In the 2014 prices. Sources: data of the Federal Treasury; Federal State Statistics Service of the Russian Federation; the author's calculations.								

Table 6. State and municipal debt of the RF subjects in 2008–2014

Indicators	2008	2009	2010	2011	2012	2013	2014
Vologda Oblast							
Received loans, billion rubles	0.2	6.4	8.5	8.9	6.7	13.3	33.2
Debt, billion rubles	1.7	11.0	19.0	26.9	30.9	34.9	38.0
Debt burden, %*	3.8	39.4	52.8	67.0	70.7	81.1	82.0
Lipetsk Oblast							
Received loans, billion rubles	0	0.55	2.9	4.1	3.4	4.8	4.4
Debt, billion rubles	4.0	6.5	7.8	10.4	13.9	17.7	22.4
Debt burden, %*	12.0	25.1	25.7	30.4	38.7	46.7	51.4
Chelyabinsk Oblast							
Received loans, billion rubles	0.7	4.5	1.5	1.2	5.5	14.3	11.9
Debt, billion rubles	0.3	4.7	11.9	13.6	20.4	28.7	30.5
Debt burden, %*	0.3	8.0	13.9	14.2	19.3	26.2	26.0
Russian Federation							
Received loans, billion rubles	230.5	474.9	576.2	548.3	709.9	1038.3	1994.7
Debt, billion rubles	599.6	1024.5	1265.5	1387.3	1596.7	2026.3	2402.3
Debt burden, %*	12.2	24.0	25.4	23.8	25.0	30.8	33.6
* The debt burden is calculated as the ratio of debt to the volume of own incomes of the RF subject's budget. Sources: data of the Ministry of Finance; the Federal Treasury; the author's calculations.							

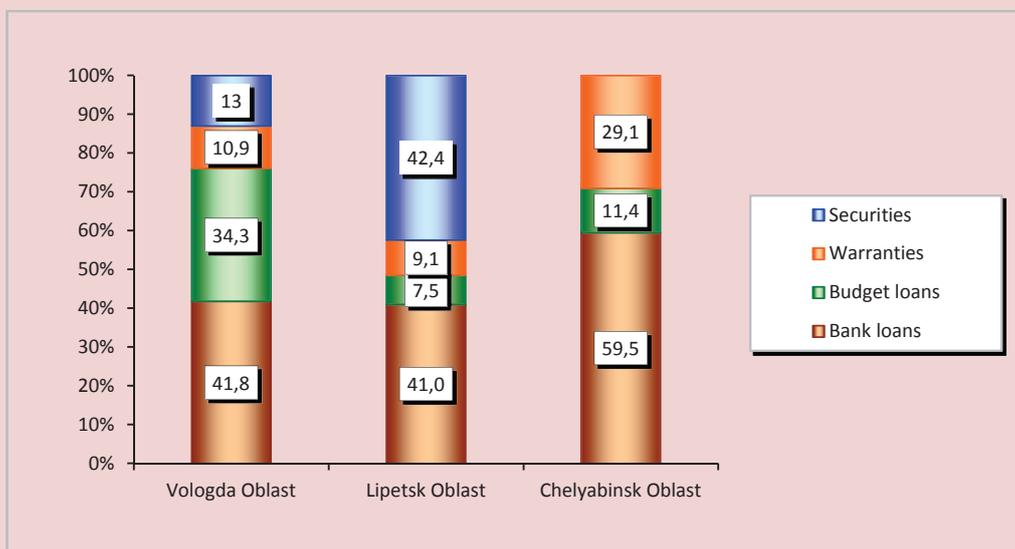
Second, the debt policies in the Lipetsk Oblast and the Chelyabinsk Oblast were aimed at hampering the attraction of credit resources. If in 2014 the authorities of these regions curtailed borrowing, in the Vologda Oblast, on the contrary, the debt load increased by 2.5 times due to the year-end budgetary loans for the substitution of bank ones.

Giving regions loans from the federal budget, the Russian Government is trying to ease their debt problems. However, to get these loans the regional authorities must meet a number of strict conditions to reduce the deficit and market borrowings. To comply with these conditions it will be difficult, since the debt crisis is caused by

the growing social expenditure under the Presidential decrees on the background of the slowdown in the economy and budgetary revenues. Besides, the aid in the form of debt financing will only lead to further worsening of the regional budgets⁶. Realizing this, the Ministry of Finance of the Russian Federation demands to forego a salary increase. *“It is most important to decide on the expenditure commitments of*

⁶ The ineffectiveness of such policy can be revealed on the example of the Vologda Oblast. Despite massive federal loans in 2014, amounting to 17.3 billion rubles, the public debt of the region continues to grow. As of June 1, 2015, it amounted to 35.2 billion rubles as compared to 34.9 billion rubles as of January 1, 2015. The dynamics of commercial loans has not changed – in the debt structure they amount to 14 billion rubles, or 40%.

Figure 1. Structure of state and municipal debt of the RF subjects in 2014, %



Sources: data of the Ministry of Finance; the author's calculations.

the regions, so that they do not increase the expenditure on salaries”, claims Minister of Finance A.G. Siluanov⁷. Certainly, the position of the financial agency is directly contrary to the strategic objectives set by the head of the state. Third, there were differences in the structure of debt (*fig. 1*).

All the studied regions have commercial loans, but if we compare them with own revenues of territorial budgets, required for further reimbursement, it turns out that after 2014 *the Vologda Oblast will have to allocate 34% of its own funds, the Lipetsk Oblast – 21% and the Chelyabinsk Oblast – 15%*. Therefore, the most onerous market

⁷ Sokrashchenie zarplat pomozhet vpolnit' maiskie ukazy Prezidenta [Decline in Wages will Help to Implement May Decrees of the President]. *Nezavisimaya gazeta* [Independent Newspaper], 2015, March 12..

component of the debt will be for the Vologda Oblast budget. In addition, the Chelyabinsk Oblast has structural advantages of debt obligations, such as high proportion of conditional (guarantee) debt, and the Lipetsk region – the share of securities, comparable with bank loans, characterized by the longer repayment period and the possibility of establishing lower rates compared to bank ones. Fourth, there was a high degree of differentiation of regions by volume of budget funds used for repayment and servicing of loans. In accordance with the budget legislation, the loans repayment is carried out at the expense of own revenue sources of the sub-federal budgets, so the budget stabilization is largely determined by the level of expenditures on these purposes (*tab. 7*).

Table 7. Expenses of RF subjects' budgets on repayment and servicing of loans in 2011–2014

Subject	2011		2012		2013		2014	
	Billion rubles	% *	Billion rubles.	% *	Billion rubles	% *	Billion rubles	% *
Vologda Oblast	5.2	13.0	8.1	18.5	10.6	24.7	28.7	62.0
Lipetsk Oblast	1.4	4.0	3.0	8.3	3.9	10.4	5.8	13.3
Chelyabinsk Oblast	1.5	1.6	3.8	3.6	6.7	6.1	6.2	5.3
Russian Federation	436.7	7.5	617.2	9.7	803.7	12.2	1729.6	24.2

* To own revenues.
Sources: data of the Federal Treasury; the author's calculations.

These data show that the Vologda oblast has the most dramatic situation, where *more than 60% of own revenues received in 2014 was used not for the development but for the reimbursement of loans and interest payments*. The Lipetsk Oblast allocated 13% for these purposes and in the Chelyabinsk region the expenditure on loans repayment was unburdensome for the budget.

The steady growth of the cost of public debt servicing poses a threat to the unconditional execution of vital commitments

to the population, forcing the regional governments to allocate priority funding to repay debt. We have no information about the reason to attract loans. However, we can get a general idea by comparing the volume of public debt and investment expenses of the budget by share in GRP (*tab. 8*).

According to the table, since 2012 these regions have been reducing capital investments and increasing public debt in GRP. Hence, the majority of attracted loans were used for financing current expenditures,

Table 8. Public debt and investment expenses of the RF subjects' budgets in 2011–2014, % of GRP

Indicators	2011	2012	2013	2014	2014 to 2011, p.p.
Vologda Oblast					
Public debt	8.3	8.7	10.2	10.5	+2.2
Investment costs	2.0	1.5	1.5	1.2	-0.8
Lipetsk Oblast					
Public debt	3.6	4.7	5.6	6.6	+3.0
Investment costs	1.6	1.2	1.6	1.3	-0.3
Chelyabinsk Oblast					
Public debt	1.8	2.4	3.3	3.1	+1.3
Investment costs	2.0	1.8	1.5	1.0	-1.0
Russian Federation					
Public debt	3.1	3.2	3.8	4.0	+0.9
Investment costs	2.6	2.2	2.0	1.7	-0.9

Sources: data of the Ministry of Finance; the Federal Treasury; the author's calculations.

Table 9. Per capita transfers from the federal budget to the RF subjects in 2009–2014

Indicators	2009	2010	2011	2012	2013	2014
Russian Federation						
Transfers, rubles	10472	9778	11500	11340	10546	11437
Vologda Oblast						
Transfers, rubles	9204	7177	8358	8800	7883	8442
In % to the national average	87.9	73.4	72.7	77.6	74.7	73.8
Transfers return, million rubles	140.8	456.6	283.8	211.8	475.7	432.7
Lipetsk Oblast						
Transfers, rubles	7574	6208	6988	7169	7238	9066
In % to the national average	72.3	63.5	60.8	63.2	68.6	79.3
Transfers return, million rubles	186.6	150.5	178.5	245.1	534.0	316.4
Chelyabinsk Oblast						
Transfers, rubles	7132	6197	6674	6864	6434	7305
In % to the national average	68.1	63.4	58.0	60.5	61.0	63.9
Transfers return, million rubles	127.9	581.0	690.4	649.4	1256.5	1269.2
Sources: data of the Ministry of Finance; the Federal Treasury; the author's calculations.						

servicing and repayment of borrowings. The use of credit resources for financial support of the current expenditures will constantly necessitate refinancing and, in the end, the debt burden can become long-term.

In summary, it can be argued that the lack of clear mechanisms to finance expenditures between the budget system levels has eventually forced the regions to *attract expensive market loans for the implementation of not only investment, but also social programs, provoking a protracted debt crisis*, and the Russian authorities have not found a way out yet.

Speaking about budgetary problems of the regions, we can not but mention that the federal government, which largely created these problems, has reduced the financial support of regions. The amount of non-repayable receipts from the federal

budget to the metallurgy-oriented regions, most affected by the crisis consequences, was by 23–37% lower than the national (*tab. 9*).

It is important to note that against the background of the inadequate allocation of transfers, most of them remained unspent due to their untimely provision by the central government and were returned to the federal budget. According to the table, this trend increased in 2013–2014, thus once again revealing the ineffective interbudgetary interaction.

The problems and their factors, despite some specific features, are characteristic of the overwhelming majority of RF subjects. In the metallurgy-oriented regions these problems are complicated by internal conditions related to the activities of the largest transnational corporations.

The presence of such holdings, strategic taxpayers, should create noticeable fiscal effects. However, the ISED T RAS research⁸ indicates that the advantages of large-scale production are not accompanied by the acceleration of socio-economic development of territories. On the contrary, the corporation represented by their parent enterprises (steel mills⁹) has formed a unique system of governance in the regions of presence and become tools of pumping out local resources in favor of the owners.

Unfortunately, the analysis of public statements of parent enterprises of ferrous metallurgy corporations in 2014¹⁰ justifies this conclusion, although financial performance was quite good. The enterprises' revenues increased by 10–18% due to the grown profitability from export sales on the background of ruble devaluation. Profit from sales was great. We should pay attention to the decline or slowdown in prime costs and costs that directly affect the tax base (*tab. 10*).

Nevertheless, the further analysis of financial statements showed contradictory

⁸ Ilyin V.A., Povarova A.I., Sychev M.F. *Vliyanie interesov sobstvennikov metallurgicheskikh korporatsii na sotsial'no-ekonomicheskoe razvitiye* [Impact of the Metallurgical Corporations' Interests Owners on Socio-Economic Development]. Vologda: ISERT RAN, 2012. 102 p.; Ilyin V.A., Povarova A.I. *Problemy gosudarstvennogo upravleniya* [Problems of Public Administration]. Vologda: ISERT RAN, 2014. 181 p.

⁹ Cherepovets Steel Mill (CHerMK), Magnitogorsk Iron and Steel Works (MMK), Novolipetsk Steel (NLMK).

¹⁰ *Ofitsial'nyi sait PAO "Severstal"* [Official Website of "PAO Severstal"]. Available at: <http://www.severstal.ru/>; *Ofitsial'nyi sait OAO "Magnitogorskii metallurgicheskii kombinat"* [Official Web-Site of OJSC "Magnitogorsk Iron & Steel Works"]. Available at <http://www.mmk.ru/>; *Ofitsial'nyi sait OAO "Novolipetskii metallurgicheskii kombinat"* [Official Web-Site of OJSC "Novolipetsk Steel"]. Available at: <http://www.lipetsk.nlmk.ru/>

trends. According to Table 10, in 2014 ***CHerMK and MMK had the largest volume of sales profit after 2009. It should have led to the increase in pre-tax profit. Instead, both steel works reported about losses and in CHerMK the loss was the most significant during the period.*** How can the situation be justified? According to the Vologda Oblast government, the CHerMK losses were caused by the fluctuations in currency exchange¹¹. Indeed, compared with 2013, the losses were by six times higher (*tab. 11*).

As shown by the results of our own analysis, the losses included the costs on dissolution of American non-core asset management companies, accounted in other expenses of CHerMK. If these expenses were not taken into account in the financial result formation, ***the company could have profit in the amount of 57.3 billion rubles. It would exceed the 2008 level. According to our calculations, loss of profit tax due to the recognition of such a substantial amount of unproductive expenditure amounted to 19 billion rubles, including more than 17 billion rubles to the Vologda Oblast budget. In short, in 2014 CHerMK had the potential to reach the pre-crisis volume of payments to the budget.*** These facts confirm the correctness of the ISED T RAS conclusions about the ineffectiveness of the business transnationalization strategy

¹¹ *Itogi sotsial'no-ekonomicheskogo razvitiya Vologodskoi oblasti za 2014 god: doklad zamestitelya Gubernatora oblasti A.V. Kozhevnikova na publichnykh slushaniyakh po godovomu otchetu ob ispolnenii oblastnogo byudzheta za 2014 god* [Results of Socio-Economic Development of the Vologda Oblast in 2014: Report of the Vice-Governor of the Region A.V. Kozhevnikov at the Public Hearing Devoted to the Annual Report on Regional Budget Execution in 2014]. Available at: <http://www.vologdazso.ru/analytic/219029/>

Table 10. Financial performance of steel mills in 2008–2014, billion rubles

Indicators	2008	2009	2010	2011	2012	2013	2014	2014 to 2013, %
CHerMK								
Revenue	243.6	143.6	209.8	254.3	223.6	212.9	233.6	109.7
Prime cost	157.4	104.5	157.5	200.8	182.2	174.2	171.2	98.3
Commercial expenses	5.3	7.2	9.9	12.9	13.9	14.2	13.8	97.5
Management costs	7.0	6.2	7.8	9.3	11.8	9.4	8.8	93.1
Profit from sales	73.9	25.6	34.6	31.2	15.7	15.1	39.8	264.4
Interest expenses	4.7	8.8	10.8	10.3	10.9	9.2	9.0	98.2
Pre-tax profit	52.8	5.8	-34.1	-1.4	16.3	9.2	-37.7	x
MMK								
Revenue	226.0	137.3	201.8	247.3	243.1	225.5	266.5	118.6
Prime cost	160.9	101.2	164.9	211.4	203.8	195.0	205.4	105.4
Commercial expenses	4.7	4.1	5.3	5.9	9.4	12.3	13.8	112.3
Management costs	6.7	5.5	6.1	6.6	7.5	7.2	6.6	91.0
Profit from sales	53.7	26.5	25.5	23.3	22.3	10.1	40.7	401.2
Interest expenses	1.1	1.6	2.3	3.5	4.4	3.9	4.3	110.6
Pre-tax profit	15.6	34.0	29.6	-5.2	11.4	-58.6	-1.3	2.2
NLMK								
Revenue	202.1	128.6	179.9	221.2	240.1	225.5	262.7	116.5
Prime cost	115.1	94.3	130.7	174.0	205.8	199.7	200.0	100.1
Commercial expenses	10.8	12.2	14.1	15.7	18.3	17.9	19.4	108.5
Management costs	3.7	4.6	6.2	7.0	7.9	8.5	9.9	116.1
Profit from sales	72.4	17.4	28.9	24.4	8.1	-0.6	33.5	x
Interest expenses	2.0	2.1	3.2	3.7	6.3	6.35	6.4	101.4
Pre-tax profit	90.2	25.8	39.0	40.8	24.2	-10.4	23.3	x
Sources: data of financial statements of the steel mills; the Federal Treasury; the author's calculations.								

Table 11. Other expenses of CHerMK in 2013–2014, billion rubles

Indicators	2013	2014	2014 to 2013, %
Other expenses, total	49.0	192.7	392.8
- exchange differences	11.5	63.4	551.3
- costs on dissolution of Severstal US Holdings, LLC and Severstal Investments LLC	0	95.0	x
Loss of tax as a result of accounting for the costs on foreign companies dissolution	0	19.0	x
- including to the Vologda Oblast budget	0	17.1	x
Sources: data of financial statements of PAO Severstal; the author's calculations.			

Table 12. NLMK Profit estimated, according to different accounting figures in 2014

Indicators	Billion rubles
Pre-tax profit (according to cost accounting data)	23.3
Taxable profit (according to tax accounting data)*	7.8
Difference	15.5
Loss of profit tax	3.1
- including to the Lipetsk Oblast budget	2.8

* Tax accounting serves as the basis for determining profit tax.
Sources: data of financial statements of OJSC "NLMK"; the author's calculations.

selected by PAO Severstal. The costs on operating foreign companies, carried out at the expense of ChErMK profits, should be recognized as means to withdraw resources from the cash flow of the plant in order to minimize the tax base. *If in 2004–2013 the average annual amount of the withdrawn financial resources amounted to 45 billion rubles, in 2014 it amounted to 95 billion rubles.* Thus, the Vologda Oblast did not get 10 billion rubles of profit tax annually.

The unprofitableness of MMK in 2014 was mainly influenced by negative exchange differences, which indicates the poor performance of the company's management on currency risk management. In addition, the increase in prime cost, commercial and interest expenses resulted in the 12.4 billion ruble decrease in pre-tax profit.

The ISED T RAS research in the problems of profit tax administration reveals significant gaps in the sphere of tax legislation¹². The extremely complex

method for profit tax calculation, based on double standards (cost and tax accounting), allows taxpayers, especially the largest, to manipulate the assessment of revenue and expenses when calculating the tax base. In practice, this often leads to the underestimation of assessed profit tax. For example, in 2014 the NLMK profit was optimized to 15.5 billion rubles for the purposes of taxation by using different ways of calculating it. Hence, the Lipetsk Oblast budget missed almost 3 billion rubles of profit tax (*tab. 12*).

The legitimate use of different schemes to minimize profit tax resulted in the profound drop in its revenue from the largest steel mills. In fact, in 2013–2014, Cherepovets Steel Mill and Magnitogorsk Iron and Steel Works did not pay profit tax to the budget. In 2014 Novolipetsk Steel's payment to the Lipetsk Oblast budget amounted to 12% of the 2008 level, while the revenue from sales increased by 30% (tab. 13).

The legitimate and large-scale decline of profit tax in the share of sales revenue indicates that the smaller part of taxes was localized at the enterprises for further mobilization to the regional budgets. The

¹² Povarova A.I. Snizhenie fiskal'noi funktsii naloga na pribyl': faktory i puti povysheniya [Reduction of the Fiscal Function of Corporate Tax: the Factors and Ways of Increase]. *Ekonomicheskie i sotsial'nye peremeny: fakty, tendentsii, prognoz* [Economic and Social Changes: Facts, Trends, Forecast], 2014, no. 3, pp. 180-195.

Table 13. Profit tax proceeds from steel mills in 2008–2014

Indicators	2008	2009	2010	2011	2012	2013	2014	2014 to 2008, %
CHerMK								
Revenue, billion rubles	243.6	143.6	209.8	254.3	223.6	212.9	233.6	95.9
Profit tax, million rubles	13961.1	3851.2	4352.9	3082.7	2280.2	0.5	0.96	0.007
- to the regional budget	10191.6	3466.1	3917.6	2774.4	2052.2	0.46	0.8	0.008
To revenue, %	5.7	2.7	2.1	1.2	1.0	0.0002	0.0004	-5.7 p.p.
MMK								
Revenue, billion rubles	226.0	137.3	201.8	247.3	243.1	225.5	266.5	117.9
Profit tax, million rubles	10511.8	507.6	1488.0	1595.0	1958.0	0	143.0	1.4
- to the regional budget	7673.6	456.8	1339.2	1435.5	1762.2	0	128.7	0.002
To revenue, %	4.7	0.4	0.7	0.6	0.7	0	0.05	-4.7 p.p.
NLMK								
Revenue, billion rubles	202.1	128.6	179.9	221.2	240.1	225.5	262.7	130.0
Profit tax, million rubles	15754.6	1284.5	5062.9	6152.8	2729.9	0	1554.4	9.9
- to the regional budget	11500.9	1156.1	4556.6	5537.5	2456.9	0	1399.0	12.2
To revenue, %	7.8	1.0	2.8	2.8	1.1	0	0.6	-7.2 p.p.
* Since there are no precise data about paid taxes, the table shows the current profit tax calculated in the statements on profit and loss. Sources: data of financial statements of steel mills; the author's calculations.								

Table 14. Balance of funds from steel mills' financial activities in 2012–2014, billion rubles

Steel mill	2012	2013	2014	Total for 2012–2014
CHerMK	-32.8	-43.8	-41.3	-117.9
MMK	-12.9	-18.1	-4.5	-35.5
NLMK	-1.5	-2.9	-37.5	-41.9
Sources: data of financial statements of steel mills; the author's calculations.				

fact that financial flows were removed from the economic activity of the ferrous metallurgy enterprises is supported by the negative value of net cash from financial activities, including dividends, loans to affiliated companies, etc. (*tab. 14*).

The cash flows withdrawn from Cherepovets Steel Mill and Novolipetsk Steel for the last three years, first, are almost by threefold higher than the annual volume of the Vologda Oblast budget

revenue and, second, equivalent to the annual budget of the Lipetsk Oblast. The tax burden of the metallurgical complex enterprises is not consistent with their profit and incomes of owners and key managers of these enterprises (*tab. 15*).

According to the table, in 2008–2014 on the background of the decline in tax burden by 1.7–3.7 times the fortune of metallurgical corporations owners increased by 1.4–3 times. Though the contribution to

Table 15. Remuneration of management bodies, state and dividends of owners of metallurgical corporations in 2008–2014

Indicators	2008	2009	2010	2011	2012	2013	2014	2013 to 2008, times
CherMK								
Remuneration of management bodies, million rubles per year	86.2	630.0	601.3	1068.5	650.0	801.6	1147.6	+13.3
Fortune of the owner, billion rubles	4.3	9.9	18.5	15.3	12.8	10.5	13.0	+3.0
Dividends of the owner, million rubles	25499	0	5272	12696	7618	5505	39165	+1.5
Tax burden, %*	11.1	2.8	4.4	4.4	3.8	4.0	3.0**	-3.7
MMK								
Remuneration of management bodies, million rubles per year	495.4	497.3	276.9	52.1	276.6	672.3	248.5	-2.0
Fortune of the owner, billion rubles	2.5	9.8	11.2	5.6	4.2	2.8	3.5	+1.4
Dividends of the owner, million rubles	3698	3556	3171	0	2685	0	5655	+1.5
Tax burden, %*	7.7	3.7	4.3	6.5	3.0	3.6	2.5	-3.1
NLMK								
Remuneration of management bodies, million rubles per year	188.1	230.9	291.9	223.5	206.5	293.6	531.0	+2.8
Fortune of the owner, billion rubles	5.2	15.8	24.0	15.9	14.1	16.6	11.6	+2.2
Dividends of the owner, million rubles	9240	1045	9330	10253	3178	3435	4511	-2.0
Tax burden, %*	11.6	5.5	6.7	5.5	6.4	6.2	7.0	-1.7
* Calculated as the ratio of taxes paid to all levels of budget, to revenue.								
** As the statements of Severstal have not disclosed the amount of taxes, the data are taken from the Federal Tax Service reporting, regarding the whole metallurgical production of the Vologda Oblast (excluding insurance premiums).								
Sources: data of the journal "Forbes"; financial statements of the still mills; the author's calculations.								

the budgetary system reduced significantly, the annual remuneration of top managers at PAO Severstal, paid at the expense of the parent enterprise, increased by 13.3 times. The revenues of 10 members of the Severstal Board of Directors exceeded the remuneration of 24 members of the management bodies at OJSC "MMK" and 18 members of the management bodies at OJSC "NLMK" by 5 and 2 times, respectively. The amount of dividends paid to the main owner of Severstal in 2014, draws our attention. *The sum was record for the entire study period. Amounting to almost*

40 billion rubles, it is almost equivalent to the volume of tax payments to the Vologda Oblast budget in 2014. As Cherepovets Steel Mill reported net losses in 2014, the shareholders should not be rewarded, according to the international practice¹³. *The dividends were paid from retained earnings. In the end, the main investment resource of the enterprise decreased by 3 times – from 98 to 32 billion rubles.* No accident that the decline of investment in fixed capital in the Vologda Oblast was the strongest among

¹³ As a rule, the largest companies in the world use not more than 25% of net profit to pay dividends.

other Russian regions in the last two years. Moreover, the main owner of Severstal controls it through the Cyprian offshore, applying a lower tax rate (5% instead of 13%), that is why *the Vologda Oblast budget lost more than 3 billion rubles of individual income tax in 2014*. The withdrawal of financial resources forced the management bodies to take loans. *Their volume increased almost by 4 times and provoked the growth of CHerMK corporate debt*. At the end of 2014 the loan debt exceeded the total revenue by 24%. Other mills curtailed the attraction of borrowed funds and were characterized by moderate debt (tab. 16).

Aggressive escalation of corporate debt, which was higher than proceeds, and withdrawal of one third of the reserved profits to pay dividends created high risks of financial stability not only for the core asset of Severstal, but also for the economy of the Vologda Oblast in terms of replenishment of

budget revenues and investment development. Thus, in 2014 the contradictory between the interests of comprador-oriented large corporations and the interests of regions of presence increased. And if *before 2009 the mechanisms to balance these interests could be assessed by the corporation's contribution to the formation of budget revenues, in recent years this criterion has lost its objectivity*.

Summarizing, it can be argued that in 2014 the budget problems of regional development were not resolved, but, on the contrary, worsened. First, the large-scale optimization, selected as the method to reduce the debt load of regions and covered investment and social expenses, has not achieved its goal. The process to increase government debt has continued in regions, already characterized by a high level of debt, increasingly affects the regions, previously having minimal obligations. Second, the increased distortion in the structure of

Table 16. Debt of steel mills in 2013–2014, billion rubles

Indicators	2013	2014	2014 to 2013, %
CherMK			
Involved loans	29.0	110.1	379.0
Debt	168.1	288.7	171.8
In % to revenue	78.9	123.6	+44.7 p.p.
MMK			
Involved loans	38.6	39.6	102.7
Debt	80.0	115.7	144.6
In % to revenue	35.6	43.4	+7.8 p.p.
NLMK			
Involved loans	57.1	13.8	24.1
Debt	112.8	119.9	106.3
In % to revenue	50.0	45.6	-4.4
Sources: data of the financial statements of the still mills; the author's calculations.			

public spending in favor of expenditure on repayment and servicing of loans can become critical for economic development of the regions. Third, the inaction of the RF Government in relation to the changes in approaches to regulating the profits of big business has not allowed the regions exporting raw materials and unfinished goods to benefit from the effects of ruble devaluation in order to increase tax payments to the budget.

Violating the fundamental principle of budgetary policy – the principle of balanced budgets at all levels – in the critical conditions of 2014 the Russian authorities continued to shift the burden of social spending from the federal to regional budgets, did not expand the revenue base, leaving the regions on the brink of survival. The anti-crisis plan, developed by the RF Government, is characterized by the clear dominance of support for banks over support for the real sector of economy and regional budgets.

The analysis of the budgets in the Vologda Oblast, the Lipetsk Oblast and the Chelyabinsk Oblast shows a lack of tools to use key resources of the territories in the state management system. As a result *the regional authorities, having no legislative levers to regulate the activities of big business, gradually are failing to implement the strategic plans of economic development and solving primarily the social problems within*

the budget allocation. Paradoxically, the regions having high-yield companies on their territories become beneficiary due to the inefficient budgetary policy. Most Russian regions require a unified system of management of industry and investment potential. Without this the economic activity will focus only on servicing the current budget deficit to the detriment of the strategic development priorities.

Developing the draft federal budget for 2016, the government structures reproduce the ideology of the budget policy for 2015, based on the sequestration of all costs. The new draft budget stipulates the by 13% costs reduction. Without structural reforms it can entail serious risks for socio-economic stability. In this situation there is little hope for the solution to budgetary problems of the regions.

In our opinion, for the initial stabilization of regional funds the Russian Government should: restructure debt on the loans issued from the federal budget; transform debt financing of the sub-federal budgets to predominantly transfer; radically change the administration of large taxpayers' profit. Refusing to change the essence of the budget policy and emptying the regional budgets, the Government demonstrates its inability to guarantee a decent living standard for Russian citizens and provokes deepening socio-economic problems, fraught with political instability.

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