



# **USAID Russian Federation Public Finance Program**

## **Third Quarterly Report**

**For the period ended September 30, 2001**

**Contractor: Deloitte Touche Tohmatsu Emerging Markets, Ltd.**

**Contract No. OUT-PER-I-800-99-00003-00**

**Delivery Order 800**

**Reporting Period: Quarter ending December 31, 2000**

**Country: Russian Federation**

**Short Title of Task Order: Russian Federation Public Finance Program**

**Strategic Objectives: S.O. 1.4; S.O. 1.3; S.O. 3.2**

## - TECHNICAL COMPONENT 1 -

### A. Development of the IGFR Reform

#### 1. ASSISTANCE TO FEDERAL GOVERNMENT: MOF, STATE DUMA, FEDERAL ASSEMBLY, OFFICE OF THE PRESIDENT

##### 1.1. STREAMLINING THE ASSIGNMENT OF SPENDING RESPONSIBILITIES ACROSS LEVELS OF GOVERNMENT

###### Ministry of Finance, Office of the President

On the initiative of the RF President, a Work Group was formed in the Summer of 2001 to develop recommendations on improving the assignment of spending responsibilities and taxing authorities across the levels of government in the Russian Federation. This Work Group is referred to as the Kozak Commission (after Dmitry Kozak, the Chairman of the Group). The aim of the Kozak Commission Group is (1) to review the current legislation on the assignment of expenditures, revenues and regulatory functions across levels of government in Russia, (2) to compare the legislated assignments with the ones that are actually implemented in real-life practices, and (3) to develop proposals on amending current legislation and propose a new law that would set the principles for revenue and expenditure assignment in Russia. This work should be completed by the end of May 2002.

The Kozak Commission is divided into seven units, of which four deal with particular government functions, such as welfare, education, healthcare, economic regulation, and environmental safety; and three are more systemic in nature, and deal with arrangement of public governance in Russia (number of tiers of government), intergovernmental relations, and contractual division of responsibilities between tiers. The Intergovernmental Unit is headed by Deputy Minister of Finance Eugene Bushmin. Ms. Galina Kourliandskaia (CFP Director) was co-opted into the Kozak Commission as a member of the Intergovernmental Unit, where she is responsible for analyzing and developing proposals on streamlining expenditure assignments.

Under the RF Constitution, government regulation of all the subject areas of government functions that the Kozak Commission is looking into is a joint responsibility of the federal center and the regions. Therefore, similar commissions were set up in all seven Federal Districts. The task of these District Commissions is to put together regional proposals for streamlining the assignment of revenue and expenditure responsibilities between the federal center and the regions. Ms. Yelena Nikolayenko from the CFP was appointed to the Privolzhsky Federal District Commission as an independent expert on intergovernmental relations, whose task is to assess proposals for individual regions and put together a consistent package of proposals coming from the regions in this District.

###### State Duma

The CFP produces analytical materials, memos, and comments for State Duma deputies, including members of the Duma Committee on Federal Budget (Subcommittee on Intergovernmental Relations) upon request and on an on-going basis. The demand for such support services increases when the State Duma is in session, and the choice of topics on which information support is requested mirrors the legislative proposals that are debated at the

Commissions and Sub-Commissions of the State Duma. Apart from the discussion of the budget proposals, and preparation for the first reading of the federal budget (see item 1.2 below), one of the hot topics discussed by the legislators at the end of summer and early fall of 2001 was the division of authority and spending responsibilities across levels of government. In response to a request coming from the Duma Subcommittee on Intergovernmental Relations, the CFP produced a package of memos and analytical materials on the federal legislative framework regarding general issues of the budgetary system and local governments

## **1.2. ASSISTANCE WITH THE DEVELOPMENT OF THE FEDERAL BUDGET-2002 (INTERGOVERNMENTAL RELATIONS)**

### Federation Council, Ministry of Finance

At the request of the Federation Council, the CFP commented on the proposed federal budget of 2002. In a memo prepared for the Federation Council, the CFP pointed out that the Budget Proposal underestimated revenues from paid services provided by public institutions (these revenues could be an important source of savings for the federal budget), and provided its estimates of the additional burden that would be imposed on regional budgets by a mandated 189% increase in the salaries of public employees.

In the course of the preparation of the draft budget for the first hearing, the CFP provided a number of memos and reference materials for the MoF Department of Intergovernmental Relations. One of the memos dealt with the influence of customs duty revenues on the tax capacity of RF subjects.

## **2. LONG-TERM ASSISTANCE TO PILOT REGIONS**

### 2.1. STAVROPOL KRAI

During the reporting period, the CFP's activities under the March 2001 contract with the Stavropol Krai (SK) Ministry of Finance (consultations on IGFR reform) included the following components:

1. The CFP monitored changes in the federal formula for allocating equalization transfers to the regions, and after each change, estimated the resulting change in the size of the equalization transfer to which Stavropol Krai was entitled. Also, we estimated the sensitivity of the size of transfer to Stavropol Krai to changes in individual parameters used in the formula, so that the Ministry of Finance of Stavropol Krai would know where to look for possible gains. The estimates were presented to the Stavropol Krai Ministry of Finance in the form of tables and a memo explaining the main factors that affect the size of the transfer.
2. The CFP provided the SK Ministry of Finance with updated versions of the revenue forecasting model, expenditure needs assessment model, and equalization transfers model. All three models were customized to reflect the special needs and features of the Stavropol Krai. The need for updates was explained by the recent amendments of the federal tax legislation and changes in regional laws, and by the shift of the baseline period one year forward. The three models permit the regional administration to forecast tax collections that accrue to regional and local budgets, to measure relative expenditure

needs of local budgets using the representative expenditures approach, and to allocate fiscal capacity equalization transfers across municipalities. The recent reform of local governments in the Stavropol Krai resulted in the considerable fragmentation of former raions (localities) into smaller jurisdictions; as such, there is very little information available on the new localities. Therefore, all three models are built on the basis of "old" jurisdictions, or city/raion data. In the future, the CFP is planning to build similar models that would reflect the new division of the Krai territory into local jurisdictions.

3. In the previous reporting period, the CFP wrote its comments on the draft law *On the Budgetary Process in Stavropol Krai* prepared by a team of local (SK) authors at the initiative of the SK Ministry of Finance. The CFP comments and proposals for improvement were well taken, and the new version of the law that was recently submitted to the Krai Duma for approval incorporates the improvements suggested by the CFP.
4. The CFP held a workshop for SK MoF officials, dedicated to formalization of IGFR relations in the region. Workshop participants were introduced to the revenue forecasting, expenditure needs estimation, and equalization transfers allocation models. They also discussed the possibility of using the formalized approach to transfers allocation during FY 2002.

Another training course was held for raion and city officials from the Stavropol Krai. The presenters from the CFP introduced the participants to the new ideology of intergovernmental regulation both at the federal and regional levels. Other topics discussed included assignment of spending responsibilities between the regional government and localities, best international practices, and reform options. The training sessions took place in a computer-equipped class (offered by the regional government) which permitted the audience to get acquainted with the CFP's new software solutions.

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## 2.2. ASTRAKHAN OBLAST

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In July 2001, the Administration of Astrakhan Oblast solicited bids for providing technical assistance to the regional government on intergovernmental reform issues. The CFP submitted a bid and won the contract. The contract covers the following services:

- Develop recommendations on monitoring factors that have an impact on estimated amounts of transfers from the FFSR;
- Elaborate a methodology for territorial and local budget revenue forecasting, evaluation of expenditure needs of municipalities, and IGFR regulation; and,
- Analyze the current system of public government bodies in Astrakhan Oblast and develop recommendations.

After the contract was signed, the CFP had several meetings with Astrakhan Oblast officials (the Head of the Finance Department, N. Yevlashev, the Deputy Head of the Finance Department, V. Sinchenko, and Federation Council member for Astrakhan Oblast, K. Markelov). During these

meetings, the CFP presented the latest versions of the FFSR transfer estimates for 2002, and explained the impact of various factors on the size of federal transfer to the Astrakhan Oblast.

The CFP is currently building the basic set of three IGR models for the Astrakhan Oblast (revenue forecasting model, expenditure needs estimation, and equalization transfers for local budgets) to be used in the budget process in 2002. Also, the CFP prepared a memo for the Oblast Administration where it showed how different local and federal factors affect the size of federal transfer to the Oblast.

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### **2.3. MOSCOW OBLAST**

The Administration and Ministry of Finance of Moscow Oblast showed considerable interest in developing cooperation with the CFP in the area of intergovernmental reform at the subnational and federal equalization transfers. The CFP is currently negotiating a technical assistance contract with the Moscow Oblast Ministry of Finance.

Even though the terms of the contract have not been finalized yet, the CFP has already started providing technical assistance to the Oblast Administration on some of the more immediate issues, such as the estimation of the size of federal equalization transfer for the Moscow Oblast in 2002, and the analysis of factors that have an influence on the size of this transfer. The CFP also began building the three basic IGR models for Moscow Oblast (revenue forecasting, expenditure needs estimation, and equalization transfers allocation).

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### **2.4. NEW PILOT REGIONS**

The Republic of Karelia and Chukotka AO have expressed their interest in developing cooperation with the CFP. The CFP is currently negotiating the areas where technical assistance is needed with respective Finance Ministries.

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## **3. SHORT-TERM ASSISTANCE TO THE INITIAL PILOT REGIONS (NOVGOROD, LENINGRAD, VLADIMIR, ROSTOV, TOMSK, TYUMEN OBLASTS, AND KARACHAI-CIRCASSIAN REPUBLIC)**

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### **3.1. PROVIDING TECHNICAL ASSISTANCE TO THE REGIONS IN MATTERS RELATED TO THE WAY THE FEDERAL GOVERNMENT ALLOCATES EQUALIZATION TRANSFERS ACROSS REGIONS**

At the request of the Novgorod Oblast Administration (Mrs. Piterova, Deputy Chief, Finance Committee), the CFP estimated the size of federal equalization transfer due to the Oblast in 2002, and analyzed the factors that led to changes in the size of transfers that the Oblast will receive in 2002 compared to 2001. To be able to make such estimates for the Novgorod Oblast and for other regions, the Center had to collect the source data and develop its own model for allocating federal equalization transfers in parallel with the RF Ministry of Finance. This is due to the fact that the MoF does not disclose either the input data for the formula or the formula (the model) itself until the budget process at the federal level reaches some advanced stage (usually the disclosure happens right before the fourth and final reading of the federal budget). However, the MoF does provide the description of the methodology it uses for building the formula, and in theory, it is possible to replicate the formula and see how changes in the formula affect individual regions. The regions, however, do not have the capacity to make such estimations, and many of them turn to the CFP for technical assistance with building such an "early warning" system.

In response to requests of the Leningrad, Sakhalin, Novgorod, Rostov Oblasts and Karachai-Circassian Republic, the CFP estimated the impact of methodological changes on FFSR transfer distribution in 2002. Also, we estimated the sensitivity of the formula to changes in various federal and regional factors. For each region that requested such assistance, we wrote memos explaining the formula including estimates of the sizes of the transfers, and explained the reasons why their transfers may become bigger or smaller as compared to the previous year. The memos were forwarded to the heads of the respective finance departments.

### **3.2. TECHNICAL ASSISTANCE TO THE REGIONS ON ISSUES THAT HAVE TO DO WITH THE METHODOLOGY OF ALLOCATING EQUALIZATION TRANSFERS BY THE REGIONS ACROSS LOCALITIES, AS RECOMMENDED BY THE MOF**

At the request of the Rostov Oblast, the Center assessed the methodology proposed by the Oblast Administration for allocating equalization transfers to local governments. The CFP forwarded its comments and suggestions for improvement to the Oblast Administration.

### **3.3. DEVELOPMENT OF REGION-SPECIFIC MODELS FOR ALLOCATING REGIONAL EQUALIZATION TRANSFERS ACROSS LOCALITIES, MODELS FOR MEASURING FISCAL CAPACITY (FORECASTING REVENUES), AND MODELS FOR ESTIMATING RELATIVE EXPENDITURE NEEDS OF LOCALITIES**

#### Novgorod Oblast

At the request of the Novgorod Oblast Administration (Galina Piterova, Vice Head of Finance Department), the CFP continued providing technical assistance to the Oblast Department of Finance. Specifically, the CFP updated the Novgorod Oblast revenue forecasting model to incorporate recent changes in the tax laws, and discussed the resulting forecast with Finance Department officials. The DoF officials decided to use the CFP revenue forecast in the 2002 budget.

#### Karachai-Circassian Republic

At the request of Karachai-Circassian Republic (Ms. Erkenova, Deputy Minister of Finance), the CFP updated the set of three IGR models for the Republic, and held a half-day workshop for local MoF officials to explain the forecast and simulation results. Karachai-Circassian Republic plans to continue its cooperation with the CFP in 2002.

#### Rostov Oblast

The CFP updated the regional IGR models for the Rostov Oblast to incorporate recent changes in tax laws.

## **4. SHORT-TERM ASSISTANCE TO OTHER REGIONS**

### **4.1. PROVIDING TECHNICAL ASSISTANCE TO THE REGIONS ON MATTERS RELATED TO THE WAY THE FEDERAL GOVERNMENT ALLOCATES EQUALIZATION TRANSFERS ACROSS REGIONS**

#### Sakhalin Oblast

At the Sakhalin Oblast's request, the CFP analyzed the reasons for a sharp drop in federal transfers to Sakhalin Oblast in 2002, compared with the previous year. With the assistance of the CFP, the Oblast Administration Finance Department put together a proposal on improving the

federal equalization formula and submitted it to the MoF. The MoF has agreed to make proposed changes in the formula that will be used for allocating transfers in the 2002 budget.

#### Nizhni Novgorod Oblast

At the request of the Nizny Novgorod Oblast Finance Department, the Center estimated the sensitivity of tax capacity and index of budget expenditures needs to changes in statistical indicators that characterize the Oblast's tax capacity and demand for public services.

#### Chukotka AO

At the request of Chukotka AO, the CFP estimated the effect of changes in the federal formula on the transfer amount due to Chukotka AO in 2002. The CFP and Chukotka AO plan to continue their cooperation and sign a short-term technical assistance contract.

#### Republic of Karelia

The CFP and Republic of Karelia signed a short-term technical assistance contract. Under this contract, the CFP will estimate the impact of federal export duties on the tax capacity of Karelia. The CFP also estimated the impact of changes in the federal formula on the size of transfers due to Karelia in 2002, and possible changes in regional tax capacities if export or export duties are excluded from the gross industrial output.

#### Other regions

At the request of Ivanovo and Pskov Oblasts, the Republic of Mari El, and Altai Krai, the CFP estimated the effects of changes in the federal equalization formula on the size of transfers due to each of these regions in 2002, and estimated the sensitivity of the size of transfers to changes in various factors that are included in the formula. The CFP wrote a memo explaining the estimation results and findings of the sensitivity analysis for each of the regions.

#### **4.3. DEVELOPMENT OF REGION-SPECIFIC MODELS FOR ALLOCATING REGIONAL EQUALIZATION TRANSFERS ACROSS LOCALITIES, MODELS FOR MEASURING FISCAL CAPACITY (REVENUE FORECAST), AND MODELS FOR ESTIMATING RELATIVE EXPENDITURE NEEDS OF LOCALITIES**

The CFP built sets of basic IGR models for a number of new regions (Karelia Republic, Sakhalin Oblast, Altai Krai, and Pskov Oblast), and updated the already existing models for the "old" pilot regions (see above).

At the request of the Chita Oblast Administration, the CFP assessed the revenue forecasting model and the transfers allocation model built by the Oblast for use in their budget process, and forwarded its comments and suggestions for improvement to the Oblast MoF.

### **5. WORKSHOPS AND ROUND-TABLE DISCUSSIONS ON INTERGOVERNMENTAL REFORM**

#### **5.2. WORKSHOPS HELD AT THE CENTER FOR FISCAL POLICY**

At the request of regional finance authorities, the CFP held a two-day workshop for regional finance officials on issues on national and subnational equalization transfers in 2002 (September 24–25). This workshop was partially funded by the participants (participating regions were the Altai Krai, Ivanovo Oblast, Novgorod Oblast, Pskov Oblast, Rostov Oblast, Sakhalin Oblast, Republic of Karelia, and Chukotka AO).

The first day of the workshop was dedicated to federal formula. Presenters from the CFP demonstrated the CFP computer model that simulates the allocation of federal transfers in 2002, and explained to the participating regions the factors that affect the size of transfers due to them from the federal budget and the sensitivity of the federal formula to changes in such factors.

The second day of the workshop was devoted to recommended approaches to fiscal capacity equalization at the subnational level. Presenters from the CFP demonstrated the IGR models, and showed the participants how they can build their own models using the custom-made model shells provided by the CFP to each of the participants.

To those regions that could not attend the workshop on September 24-25 (Mari El and Karachai-Circassian republics), the CFP provided individual assistance on the issues discussed at the workshop at later dates.

The CFP also held a number of in-house workshops for its own employees. One of such workshops was dedicated to issues of fiscal federalism, and another to the discussion of the 2002 Budget Proposal.

## **6. PUBLICATIONS**

Galina Kurlyandskaya, Yelena Nikolayenko and Antonina Kovalevskaya contributed two chapters – one on IGFR relations and another one on federal tax policies – to the yearbook *Russia-2000 Economic Review* published by the Bureau of Economic Analysis.

A collection of articles authored by participants to the international conference on IGFR issues, held by the CFP on June 18-19, 2001 in Golitsyno (Moscow Oblast), was prepared for publication.

In the reporting period, CFP experts gave several interviews to central newspapers on general budget policy issues, allocation of budget revenues across tiers of government, tax exemptions to free economic zones, “restricted access” territories, and inclusion of extrabudgetary earnings of spending agencies into budget revenues.

### **B. Improvement of the Budgetary System and Federal/Regional Expenditure Reviews**

#### **1. FEDERAL**

The FPC completed the bulk of the work on Public Expenditure Reviews in Q2 by delivering reports on roads, extrabudgetary revenues of public agencies, and research and development. The report on federal spending on roads was part of a larger report on federal spending on transport, of which roads was only one, albeit by far the largest expenditure item. Other transport expenditures that the MoF wanted analyzed included northern airports, ice-breakers, and inland waterways. These reports were completed and delivered to the MOF in Q3 (see below).

As for earlier reports, they produced considerable feedback both on the part of the news media (see item 4 –*Publications* below ), other Russian think-tanks conducting public expenditure reviews for the MOF, and international donors.

The organizations (think-tanks) that completed the first round of public expenditure reviews were asked to report their findings at a workshop held at the World Bank (WB) Office in Moscow for MoF officials. At the workshop, the FPC reported its findings and proposals concerning roads, extrabudgetary revenues, and R&D. The findings and proposals were met with considerable interest both by the MoF representatives and WB experts. As a follow up, FPC experts were invited to the WB Office to discuss federal involvement in the transport sector and R&D with WB experts Alfred Watkins (R&D) and Ashot Haroutunian (transport), as well as discuss possibilities for future cooperation in these areas.

There was no direct feedback from the MOF, either on our earlier reports or the ones that were delivered in Q3 (see description below). However, the MoF official in charge of Public Expenditure Reviews (Artem Shadrin) asked the Center to help the MoF to write up a plan for this activity for fiscal year 2002. The FPC wrote a proposal describing the areas of federal expenditures and institutional issues that we think should be analyzed in the coming year. This proposal included both a more detailed analysis of the areas already reviewed in 2001, and new topics such as performance budgeting, streamlining the funding of federal programs, reporting procedures, etc. Also, Deputy Minister of Finance Alexei Ulukayev made references to some of the FPC's findings in his interview to *Vedomosty*, a major Russian daily.

#### **1.1. PUBLIC EXPENDITURE REVIEW OF THE FEDERAL BUDGET ON ICE-BREAKERS**

At the request of the RF Ministry of Finance, the CFP reviewed the current situation with funding the fleet of ice-breakers. The main objective of the research was to develop recommendations aimed at more effective federal spending on ice-breakers. The research was based on the Concept of Fiscal Expenditure Policy elaborated by the MoF in 2001. Though the Concept contained no specific references to the ice-breaker fleet, the general guidelines formulated in it provided the necessary framework for the research that was required in order to develop measures for a streamlined expenditure policy to be followed in the immediate future and mid-term perspective. The main conclusions of the CFP experts were included in speeches of Deputy Finance Minister, A. Ulyukaev.

#### **1.2. ANALYSIS OF FEDERAL BUDGET SPENDING ON FINANCIAL AID TO NORTHERN AIRPORTS**

The CFP was assigned by the RF Ministry of Finance to carry out an analysis of the situation on funding northern airports (within the time and information limits set by official agencies), and to suggest actual steps to improve the efficiency of federal spending in this sector. The research focused on the airports situated in the Far North and similar areas. In accordance with the Concept of Fiscal Expenditure Policy elaborated by the MoF, the CFP researchers inventoried the responsibilities of the federal center, identified the main problems, and recommended ways for increasing the efficiency of federal spending on northern airports. Unique statistical data on northern airports' activities were collected and analyzed in the course of the review effort.

### 1.3. ANALYSIS OF FEDERAL BUDGET EXPENDITURES ON INLAND WATERWAYS

The Ministry of Finance requested that CFP specialists assess public expenditures on inland waterways sector as an element of the Russian transport system that included the following components: *infrastructure*: network of main communications (waterways), hydraulic structures (HS locks, dams, hydraulic power stations), auxiliary fleet, etc.; *service system*: buildings, equipment, auxiliary communications, and land; *transport*: cargo transportation activities; and *services*: core (locking, maintaining hydrostatic pressure, pumping water to farmland irrigation, piloting, cleaning of waterways) and auxiliary (forwarding, storage, distribution, value-added logistics) services.

The report concentrated on those elements of inland waterway sector (infrastructure, service system, and part of service functions) that had been privatized and yet, received support from the government. The CFP specialists recommended some ways leading to more efficient government spending on this sector.

### 1.4. REVIEW OF FEDERAL GOVERNMENT EXPENDITURES ON CRIMINAL JUSTICE (COURTS AND PENITENTIARY SYSTEM)

In this report, we assessed the role of the government in delivering law and order. The focus of the report was on courts and the penitentiary system. However, in order to present a broader view of these two functions, the report also gives an overview of other related public services, such as policing and crime prevention.

The analysis of the existing system of courts and jails is especially important in view of the forthcoming major reforms in this area. At present, there are several conflicting proposals on what to do with courts and jails (both are federal functions in Russia), and the Federal Government has not yet finalized its reform strategy in either of the fields, even though it is determined to start the reforms in 2002. Therefore, the MoF has to budget for the reforms in its Budget Proposal without a clear understanding of what the reforms will be about. We expect that our Report will be met in the MoF with considerable interest.

The FPC has analyzed the existing practices of budgeting expenditures on courts, pinpointed several important weaknesses of the existing system, and proposed ways to strengthen the autonomy of the judiciary and improve upon the efficiency of courts.

The public expenditure review in question also investigated ways to improve the efficiency of public spending on the penitentiary system. These issues practically had never been explored before. Recommendations on major institutional changes were developed to reform the system of public expenditures on criminal justice. In addition, a methodology for calculating public expenditure rates for courts and other penitentiary institutions was offered.

In the reporting period, we developed our proposals on the terms of references for the following projects:

- Multi-year budgeting: what can be gained by using the multi-year approach?
- Overview of the theory and international practice of performance-based budgeting.
- Transition to performance budgeting: a strategy for Russia.

- Development of criteria for transparent estimation of expenditure needs of spending agencies.

The work on the above projects has already started and first results with regard to performance-based budget and expenditures need assessment were included in the report on the federal government expenditures on criminal justice prepared by the CFP consultants.

## 2. REGIONAL

### 2.2. MOSCOW OBLAST

The contract with the Moscow Oblast has not yet been signed. However, the Oblast Administration has already expressed its interest in having public expenditure reviews conducted for a number of public services delivered by the regional government. One area of interest is public transport. The CFP already started to collect information on public transportation performance in the Oblast.

## 3. WORKSHOPS AND ROUND-TABLE DISCUSSIONS ON WAYS TO REFORM THE BUDGETARY SYSTEM IN RUSSIA

Workshops at the WB Office in Moscow (see item B.1. Federal above)

## 4. PUBLICATIONS

Copies of CFP reports were distributed to the MoF, interested federal ministries, and other Russian think-tanks. The reports are available for public access on the CFP website.

The CFP gave a number of interviews explaining its findings to the press, including interviews to two leading Russian dailies: *Vedomosty* and *Argumenty i F акты*. One interview was broadcast on TV.

A member of the CFP team Yury Kuznetsov published an article on federal expenditures on roads in a popular electronic magazine, «Polit.ru» - *Road socialism, or the anatomy of a budget hole*.

## C. Development of New Information Technologies and Database Applications

### 1. DATA COLLECTION

#### 1.1. COMPLETING THE 2000 UPDATE OF THE REGIONAL/LOCAL BUDGETS DATABASE

During the reporting period, the CFP received consolidated budget execution reports from 87 regions, and disaggregated (broken down into regional and local) budget execution reports from 37 regions.

### 2. DATA ORGANIZATION

#### 2.1. TRANSFORMATION OF ALL COLLECTED DATA INTO MS EXCEL\ACCESS FORMAT

Information on the execution of raion budgets in 37 RF subjects was transformed into MS Excel\Access format.

## **2.2. ORGANIZATION OF COLLECTED AND TRANSFORMED DATA STORAGE**

Information on the execution of regional consolidated budgets was included in the file containing such data on all consolidated budgets of the Russian Federation. Data on population size of cities and raions of all RF subjects were added to the database.

At the request of the World Bank, the results of the 1999 election campaign to the State Duma (primary voting lists) in the regions and polling results for party candidates as well as in electoral districts were also formatted into MS Excel\Access format. New data were added into the CFP's database.

## **5. UPDATING THE MODELS OF TRANSFER ALLOCATION, FISCAL CAPACITY ESTIMATION, EXPENDITURE NEEDS ESTIMATION**

1. To evaluate the impact of changes in the federal transfer allocation formula on the size of transfers to the regions, the Center had to reconstruct the new MoF formula using the general methodological guidelines of the MoF and its own sources of data (also see item 3.1 - Providing technical assistance to the regions on matters related to the way the federal government allocates equalization transfers across regions above).
2. The Center released a new revision of the regional revenue forecasting model and a new user manual. This contains a description of revenue forecasting methodology, a description of fiscal capacity estimation methodology, a technical description of the model, and step-by-step instructions on using the model. This new manual was sent to the Stavropol Krai Ministry of Finance and distributed to the participants of the CFP Workshop in September.

## - TECHNICAL COMPONENT 2 -

### A. Establish and Strengthen the CFP Governance and Management structures

#### 2. DEVELOP FPC THREE-YEAR STRATEGY

##### 2.1 HOLD STRATEGIC PLANNING RETREAT WITH CFP TOP MANAGEMENT

Consultants Georges Korsun, Alisa Pereira, and Dan Mosher conducted a three-day workshop (July 7-9, 2001) focused on strategic planning and business development for the CFP. The objectives of the workshop were to: (1) introduce the key elements of organizational development and business planning; (2) reach consensus on an organizational vision; (3) begin creating the CFP's medium-term strategy; (4) present important components of new business development; and (5) outline success factors for effective proposals. During the workshop, the strategic planning module included exercises targeting mission statement development; SWOT analysis; competitive analysis; and organizational strategy concepts. The business development module focused on identifying appropriate clients and other funding sources; pinpointing and pursuing engagement leads; USAID and World Bank procurement practices; and RFP analysis and proposal preparation.

#### 3. CONDUCT MANAGEMENT AUDIT OF CFP POLICIES AND PROCEDURES

##### 3.1. FINALIZE ORGANIZATION CHART

In the reporting period, the CFP finalized its organizational chart. The new chart includes the following units:

- Long-term IGFR assistance to the RF regions;
- Consultations on short-term basis to the RF regions;
- Analysis of budget process and expenditures of different tiers of government; and
- Realization of the World Bank project on improvement of the federal IGFR legislation.

#### 4. DEVELOP HUMAN RESOURCE POLICIES

A Human Resources Specialist was identified, and is scheduled to provide Technical Assistance during Quarter 4 (November 2001). His scope of work includes developing personnel evaluation systems and a classification system for personnel, providing an outline and draft employee guidelines/handbook, and developing recruitment policies and tools. Following this exercise, the CFP will be able to conduct personnel evaluations before the end of the year.

##### 4.3. DEVELOP RECRUITMENT POLICIES

The International Research & Exchanges Board (IREX) invited the Center for Fiscal Policy to the Sixth Annual Career Forum & Job Fair in Moscow. This event, sponsored by the Bureau of Educational and Cultural Affairs (ECA) of the U.S. Department of State, provided an opportunity for organizations to meet and network with Russian graduates of university-level U.S. government-sponsored programs and independent graduates of U.S. universities. Approximately 40 organizations (commercial and non-profit) participated in the Job Fair. Galina

Kurlyandskaya and Antonina Kovalevskaya met with highly qualified USG-program alumni who were looking for jobs (in most cases, they had recently returned from the US). The Fair provided an opportunity to disseminate information about the Center's projects to approximately 300 attendees. By participating in the fair, the Center was able to present its projects to other leading Russian and international organizations, and attract attention from potential employees.

## **B. Develop and Establish Center Financial Sustainability Functions**

### **1. DEVELOP AND IMPLEMENT A MARKETING STRATEGY**

In order to increase its visibility with international donors, prospective partners (think-tanks), and clients, the CFP designed a leaflet that describes the activities of the Center, its mission, and main partners. It offers information about consultative services rendered by the CFP in such areas as budget revenue forecasting, improvement of the budgetary system, and the budget process. The most important results of the CFP's work are also described in the booklet.

Letters of invitation to collaboration with attached booklet copies will be sent to legislative and executive bodies of the Russian regions.

The CFP is also distributing papers and other materials written by the Center (and available in English) to interested prospective international partners and donors on CD disks. The Russian version of the disk will also be released soon.

### **2. ASSURE COMPLIANCE WITH USAID REGULATIONS**

#### **2.1. CONDUCT FINANCIAL AUDIT OF CFP**

On July 23-27, 2001, the Office of Financial Management, USAID/Russia, performed a financial review of Contract Number OUT-PER-I-800-99-00003. The objectives of the financial review were as follows:

- To review Deloitte Touche Tohmatsu Contract No. OUT-PER-I-800-99-0003 Fund Accountability Statement (FAS) pertaining to its Russian-based program costs to determine if it presented fairly, in all material respects - receipts, expenditures, and remaining fund balances, and if it is in conformity with generally accepted accounting principles;
- To obtain sufficient understanding of Deloitte Touche Tohmatsu's and its subcontractor's, the Center for Fiscal Policy, financial control structure applicable to the FAS so as to be able to access control risk and identify reportable conditions, including material weaknesses that may impact project activities;
- To review whether Deloitte Touche Tohmatsu had complied, in all material respects, with the laws, regulations, and terms of the Contract for the Russian-based program costs shown in the FAS.

During the review, the following documents were studied by two reviewers:

- Policies and procedures that presented the codified policies on Travel and Per Diem, Russian staff locally paid allowances and benefits, payroll processing, nonexpendable property management and reporting, payment/receipt processing, personnel recruitment, selection, salary and hiring, and preparation of summary reports.
- Samples of all financial control and related administrative processing forms in use, list of contract-funded personnel by name and title, personnel files including resumes, job descriptions, bio-data sheets, employment contracts and orders; organization chart, and samples of personnel forms in use.
- Expense reports prepared by the Center for Deloitte for the period from the beginning of the Project through June 2001.
- Contracts with the Center's vendors, bank statements and reconciliation reports, financial records covering all costs incurred during the life of the agreement.
- Government of Russia accreditation and registration certificates.

### **C. Public Outreach activities to support Center reputation and financial sustainability**

#### **1. ENHANCE CURRENT WEBSITE**

##### **1.1. CONCEPTUAL DESIGN AND FEASIBILITY STUDY**

The design of the English version of the CFP site was corrected and improved. It incorporates additional information on the projects of the Center regarding the review of federal budget expenditures on the transport and road sectors, fundamental research and science, and accounting of extra-budgetary incomes of public institutions. Data on the Russian tax system were updated to include tax bases, rates and tiers of government where federal, regional and local taxes were due as of September 2001.

During the third quarter, the CFP's site was visited more than 2,000 times by Internet users in Russia, the EU, USA, Canada, Japan, Argentina, and Brazil.

#### **2. IMPROVE VISIBILITY THROUGH HIGHER PROFILE PUBLICATIONS**

The following studies/articles by CFP specialists were published during the third quarter:

- Galina Kurlyandskaya and Yelena Nikolayenko, Intergovernmental Relations at the Subfederal Level in: Russian Economic Review of 2000, Moscow, Teis, 2001.
- Antonina Kovalevskaya, Tax Reform in: Russian Economic Review of 2000, Moscow, Teis, 2001.
- Road Socialism, or an Anatomy of a Budget Hole, by Yury Kuznetsov, an article written on the basis of the report on the assessment of the federal budget expenditures on the road sector and published in Polit.Ru <http://www.polit.ru/documents/437998.html>

The FPC experts were interviewed many times by journalists of central newspapers including Vedomosti, Argumenty i fakty and Izvestia. G. Kurlyandskaya and L. Bogdanov gave interviews to RENTV television company and spoke on problems in the road sector.

Following the workshops where the projects reviewing federal budget expenditures on the road sector and incomes of public institutions from extra-budgetary funds were discussed, two articles were published in Vedomosti and Argumenty i fakty newspapers. They contained the conclusions made by the CFP experts pertaining to federal funding problems.

#### **D. Enhance CFP capabilities**

##### **1. ADDITIONAL EXTRAMURAL TRAINING**

###### Training Tour to Canada

On September 8 – 17, three members of the CFP staff – Galina Kourliandskaia, Anna Suchkova, and Natalia Barbashova) visited Canada on a study tour. The tour was organized with the assistance of the Canadian International Development Agency (CIDA). The purpose of the tour was to learn more about the assignment of responsibilities across levels of government and the IGFR system of Canada as a federal state. Participants in the study tour visited the following organizations:

- In Toronto, they visited the Ontario Ministry of Finance and met with Ministry officials to discuss the system of equalization and methods of federal transfer allocation, the status of municipalities, and the division of expenditure assignment at the national and subnational levels. The Canadian system of two-tier local governments was of a special interest in the context of the local self-government reform in Russia.
- They also visited the Association of Municipalities, the University of Toronto, and the Centre for Russian & East European Studies (the role of the Association in budget process, types of municipalities, sources of municipal revenues, list of municipal responsibilities, and current issues facing municipalities). Galina Kurlyandskaya made a presentation dedicated to IGFR reform in Russia, and the FPC activities to professors and students of the University of Toronto.
- In Kingston, the group visited the School of Policy Studies at Queen's University where they discussed the current issues of federal-provincial intergovernmental and fiscal relations, the role of the mayor in municipal government and responsibilities of municipal powers, the evolution of IGFR in Canada, and the situation of the Canadian municipality in the context of federal-provincial-municipal relations.
- In Ottawa, the group visited the Ministry of Finance. Canadian officials paid great attention to the Russian delegation. They made a number of presentations on the IGFR and tax system of Canada.

The study tour proved to be very useful. Apart from learning new things, the participants were able to share their experience with Canadian counterparts and establish new contacts.

#### Tour to the USA

Two members of the CFP staff (Yelena Nikolayenko and Oleg Amirov) went on a study tour to the USA on July 21 –30. The timing of this tour overlapped with the timing of a study tour organized by USAID for financial officials of the Russian regions. Therefore, members of the CFP had an opportunity to join regional officials at some of their meetings, but also had their own separate agenda that was set up for them by Deloitte. Organizations visited during the study tour included:

- The Research & Analysis Department of the Government of the District of Columbia;
- The Department of Transportation Federal Highway (in connection with the Public Expenditure Review on Roads that the CFP had recently completed);
- The Center on Budget and Policy Priorities (a Washington-based NGO that is very similar to the Center for Fiscal Policy in terms of activities, clients, sponsors, etc.);
- The Administration of the Fairfax County; and,
- The Administration of the Arlington County.

#### Improving Policy Analysis Practices in Russia Training Program

One member of the CFP staff took part in a training program called Improving Policy Analysis Practices in Russia. This program was organized by USAID for members of Russian think-tanks, and was held in Washington DC on September 1 –22. The training covered the following issues:

- Choice of audiences and communication of think tanks' findings to policy makers, opinion leaders, and the general public;
- Forms of presentation of policy analyses;
- Maintaining links to the government while preserving professional independence and impartiality;
- Association of think tanks with political and economic platforms;
- Economic and political constraints of policy making; and,
- Sustainability of think tanks

This program provided a great opportunity to learn the experiences of American think-tanks, and to establish a network among experts from Russian think tanks.

### **3. ATTENDANCE AT PROFESSIONAL CONFERENCES**

- Presentations at the WB workshop held on July 7, 2001 on the findings of Public Expenditure Reviews conducted by the Center. Follow-up discussions with WB experts.
- Participation in the Work Group of the Russian Union of Entrepreneurs and Industrialists on issues of tax reform and monetary regulation.

- Presentation at a conference organized by the Institute of Privatization and Management (Minsk, Belarus) on reforming the energy sector (August 4, 2001).

#### **4. NETWORKING AND EXCHANGING INFORMATION WITH RUSSIAN AND FOREIGN ORGANIZATIONS**

Networking and information sharing are important areas of FPC activities. The FPC regards this as a way to increase its visibility in the policy research community, and establish closer working relations with other leading think-tanks. During the reporting period, the CFP had several requests for assistance coming from other research institutions, government agencies, and international donors. These included:

- At the request of the WB Office in Moscow, the CFP prepared a memo on the share of housing and communal services expenditures in total spending of federal and regional governments on education, health care, and welfare, at the request of Reto Steiner from National Science Foundation Project "Reforms of Local Authorities", University of Berne. The CFP wrote a memo on the structure of local self-government in RF.
- At the request of RF Goskomstat, the CFP produced a report on regional budgets executions using the MoF data stored in the CFP database.
- At the request of the MOF, the CFP prepared a memo on the population size, shares of urban/rural residents, population density, and other measures of demographic disparities across regions.
- At the request of the Soros Local Government Initiative Project (Hungary), the CFP conducted an evaluation of a paper on local governments in Russia written by Yekaterinburg University (Russia).
- At the request of the MOF, the CFP prepared a memo on cases of inefficient expenditure assignments across levels of government
- At the request of DFID, the CFP prepared a list of deliverables produced by the Fiscal Policy Centre during its existence.
- USAID has started a new program of assistance to Russian economic reforms. The project executor is the Louis Berger Group, Inc.. Mr. Scott Thomas, a senior economist of the Louis Berger Group, visited the Center to discuss the needs of the Center in receiving professional assistance of leading USA experts, and possibilities of receiving grants for research efforts under the project.

#### **5. ESTABLISH EXTRAMURAL FUNDING FUNCTION**

1. In the third quarter of 2001, the CFP was engaged in preparing the contract under the World Bank project, Development of the Federal and Regional Legislation on the Interbudgetary Relations and Sub-federal Finances, with the RF Ministry of Finance as the client. Under this contract to be signed in October 2001, the CFP is to furnish the following services - review of current legislation, development of concepts, drafting federal regulations and model laws for the regions in the area of general arrangement of

the tiers of public government, assignment of expenditure responsibilities across levels of government, unfunded mandates, social norms, and financial support of local governments.

2. The CFP has concluded contracts with two new pilot regions (Astrakhan Oblast and Republic of Karelia). A contract with the Moscow Oblast is at the negotiation stage.
3. The Eastern Europe and Central Asia Department (EECAD), and the Department for International Development (DFID) requested Expression of Interests for the management of a technical assistance facility to improve the capability of regional governments in Russia to manage all aspects of their finances. The essence of the DFID project is to create a Technical Assistance Facility as a Resource Center to meet this requirement for implementation assistance in the regions.

The CFP, in consortium with P-E International Consultants Ltd, DFC Ltd. and the Institute of Public Finance Ltd., forwarded an Expression of Interest for the project.

4. In August of this year, the World Bank announced its intention to grant loans to Moldova, Kazakhstan, and Ukraine for reforming their systems of public finance, intergovernmental relations, state procurement, and reporting. The CFP prepared and forwarded letters to the ministries of finance of Ukraine, Moldova, and Kazakhstan, offering them its services in the areas of public finance and IGFR.
5. The CFP is carrying out its obligations under a contract concluded with the Stavropol Krai Government in the previous reporting period. The amount of the contract is US\$90,000, of which the Stavropol Krai Government pays 40% and 60% is provided from the USAID project.
6. In July 2001, in response to a solicitation for bids announced by the Astrakhan Oblast Administration, the Center submitted its proposal to provide technical assistance to the Oblast Government on IGFR reform and improving the budgeting process. The CFP's financial proposal amounted to \$55,000, of which 50% were to be paid by Astrakhan Oblast and the rest funded by the USAID project. The contract for services was awarded to the Center.
7. The Center sent a Letter of Interest to participate in the World Bank Regional Finance Reform Project in the Novosibirsk Oblast.
8. The Center forwarded a Letter of Interest to the Russian Foundation for Legal Reform, expressing its interest in participating in a World Bank project in cooperation with Gowlings, one of Canada's oldest leading diversified-practice law firms. The project's goals are to:
  - Study legal gaps and inconsistencies in federal legislation regulating economic reforms in the Russian Federation and draft proposals on their elimination;

- Study the division of authority and responsibility between federal executive bodies in the area of regulation of the economy;
  - Draft federal law on commercial liabilities of the Russian Federation, subjects of the Russian Federation and municipal entities; and,
  - Draft federal law on pre-trial stage of labor dispute resolution
9. In cooperation with the Netherlands Economic Institute, the Center for Fiscal Policy forwarded an Expression of Interest to participate in the World Bank project on transport in Russia.