

## **Analysis of the Reasons and Consequences of Economic Differentiation of Regions**

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**Abstract:** The study establishes the reasons for economic differentiation and defines the sources of economic disparity of Russian regions as well as analyses forms and methods of economic support and sets out measures aimed at eliminating economic development imbalance of subjects of the Russian Federation. Sources the reasons and sources of economic differentiation of regions are established, classification by the level of economic development is carried out them, the inefficiency of traditional forms and methods of economic support is proved, changes in the mechanism of the budgetary crediting are considered, the assessment of efficiency of the policy of alignment of a financial position of various territories pursued by the federal center is given. The measures directed on increase of balance of regional budgets are analysed: offers on redistribution of profitable sources between budgets of subjects of the Russian Federation and local budgets; specification of forms of the interbudgetary transfers sent to regions, including introduction of grants for ensuring balance of the budget, “horizontal interbudgetary transfers”, restriction of the sphere of the interbudgetary transfers, toughening of requirements to distribution of subsidies exclusively laws (decisions) on the budget. It is proved that now the high level of the risks caused by increase in volumes and deterioration of conditions of service and repayment of debt obligations of subjects of the Russian Federation and municipalities at simultaneous reduction of the tax income of the consolidated budgets of subjects remains.

**Key words:** Region, debt loading, federal policy, regional policy, regional strategy, industry

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### **INTRODUCTION**

Differentiation of the Russian regions on the level of social and economic development continues to remain one of priority problems which did not manage to be solved during the post-reform period as the high level of interregional distinctions continues to remain as on indicators of VRP and the income of the population and on the volumes of investment into fixed capital and the budgetary security the available gap in development of subjects of federation interferes with carrying out the uniform economic policy directed on formation of the national market. Delay of rates of economic growth, introduction of economic sanctions and also turbulent processes in world economy do not give the serious grounds to hope that in the near future it is necessary to expect noticeable improvement of a situation that demands development of the effective mechanism of regional development.

### **MATERIALS AND METHODS**

In the real work research of the reasons of growth of debt load of subjects of federation is conducted, the assessment of level of a public debt in a section of subjects is carried out and on the basis of the statistical analysis of data regions with the greatest level of the budgetary risks are revealed.

Within after-crisis years nothing has significantly changed in evening the geographical differentiation of Russian regions, since the rate of crisis decline and the rate of after-crisis economic recovery are dramatically different. Also, the level of interregional division with regard to both gross regional product and personal income and to investments in capital stock and fiscal capacity is still high. Slackening in the rate of economic growth, economic sanctions as well as turbulence in the global economy do not afford any serious hopes that the

situation will significantly improve in the near future (Anderson *et al.*, 2010; Barro, 1989; Checherita and Rother, 2010; Cochrane, 2011).

There is no need to prove that Russian regions differentiation in social and economic development is still one of the top problems which has not been solved within the after-reforms period. The existing gap in development of subjects of the Russian Federation prevents carrying out single economic policy aimed at nation-wide market creation (Gale and Orszag, 2003).

It is a paradox but the fact is that the first regions to experience the impact of the recession were those where income during economic growth was high. It certainly can be partly explained by the fact that the former benefits were due to the favorable conditions in export industries, since these industries are the source of the most budget receipts. It is natural that under the conditions of reduced global economy requirements of hydrocarbon economic prosperity of these very (the most prosperous) subjects has been broken. It is clear that the budget receipts have been primarily impacted by decline in tax revenues from oil and gas industry. However, profit tax revenues just collapsed all over the country and in 2013 declined by 17% as compared to 2012. It is the most evident in the regions which are traditionally considered, the most economically developed: in Moscow, the Khanty-Mansi and the Yamalo-Nents Autonomous Area.

Under the threat of depression, we have to make a sober estimate of the situation and re-estimate the potential of our country's regions. The sooner we will do it, the more chances, we have to change the situation which is not quite favorable for the Russian economy (Groneck, 2010; Elmendorf and Mankiw, 1999).

At this, we can state that the situation is gradually changing. This means that relative positions of Russian

regions change (Siti *et al.*, 2013). For instance, within the recent three years the leading positions are hold by the regions where massive capital investment projects have been still implemented. All these projects have received budget support, so their future is still undetermined, since the threat of new western economic sanctions still exists. Besides, aggravation of recurrent budget problems and rise of new ones (due to changing geopolitical situation, expansion in the number of subjects and etc.) will hardly allow further financing in the planned volume (Hanson, 2007; Keynes, 1936; Kutivadze, 2012).

## RESULTS AND DISCUSSION

Moreover, judging by the gross regional product indexes it can be concluded that even in circumstances where the rate of economical growth in 21 subjects of the RF (including Moscow) has been preserved, the pre-crisis level has not been attained. The primary reason for that is slow recovery of industrial production. With this regard all subjects of the Russian Federation can be divided into three nominal groups (Table 1).

It is noteworthy that the key problem of the third group subjects is weak economic stability and high budget risks resulting from external threats. Therefore, they tend to be the first to be affected in case of further macroeconomical degradation. That's why, administration of these subjects should promptly search out growth areas, thus allowing for increasing their budget revenues and improving their budget stability. However, this problem is not very easy to solve since the outsider regions have not enough mineral resources and solid manufacturing enterprises which can secure significant budget revenues (Modigliani, 1961; Moore and Chrystol, 2008; Sutherland and Hoeller, 2012).

Table 1: Bases of RF subjects classification with respect to economical development level

Subjects of the RF	Description
<b>Group I</b> Regions with the best opportunities for solving the budget problems for instance, Moscow and Saint-Petersburg and corresponding oblasts the Krasnodar Krai	In the first two regions the above stated factors caused also the deepest budget gaps in rubles while their budgets are the biggest and the most stable ones due to the fact that these regions can easily attract borrowed money and borrowing volume will not be very substantial as compared to the regional economy volume. The Krasnodar Krai has high growth capacity after Sochi Olympics
<b>Group II</b> Moderately industrialized region holding the medial position for instance, the Sverdlovsk, the Samara, the Chelyabinsk, the Lipetsk and other oblasts	The situation in these regions is the most complex: they have no margin of safety and they are at risk, since the federal center disassociates itself from solving their budget problems. The reason of these problems lies in overdependence on financial outcomes of one industrial sector. In circumstances where profit tax revenues decline, this has exposed these regions to a risk. In fact, this group has no way to fill the financial gap other than to borrow money. The current situation is not at large quite favorable for this, all the more, so that international agencies reduce their credit scores
<b>Group III</b> The most economically backward regions for instance, North Caucasus, the Tuva Republic, the Magadan oblast, Chukotka, Altai, Kalmykia, the Kamchatka Krai and etc.	These regions traditionally belong to this group and they still hold this position. It is quite clear that deprived of a large budget support from the federal center all these territories will go into bankruptcy at once. That's why it is these territories that receive the most part of interbudget transfers. At these, they continue to be poor regions but safe from bankruptcy

Analyzing the existing situation, it can be noted that the current trends in social and economical development of Russian regions are utterly complex and controversial. To some extent it is due to unfavorable foreign policy and economy background where protectionist practices, particularly as a feedback for overseas pressure on the country are observed (Schclarek, 2005).

Utter inhomogeneity of the Russian economic space manifests itself in significant difference in average and real personal income in different regions of the country.

The volume and the structure of gross regional product show significant inhomogeneity of regions' social and economical development and not only with respect to the rate of gross regional product. The same imbalance is observed in investments, innovations and demography. There is no need to prove that this causes imbalance in development of the country's economy as a whole. At the same time, serious budget problems of industrialized regions results from high dependency on revenues from one economy sector (Shash and Afanasyev, 2014; Shash *et al.*, 2014; Borodin *et al.*, 2015).

Moreover, some specialists consider that recent years see the further aggravation of existing regional imbalance in economical development. Still existing threat of regional crises and interregional conflicts in circumstances where donor regions fail to secure the former level of revenues into the federal budget is another important problem. Reasons for significant economic disparity of Russian regions traditionally include the following:

- High market monopolization in depressed regions
- Unequal allocation of investments for long-term projects among regions
- Misuse or inefficient use of public funds for measures for industrial facilities development in problem-plagued
- Insufficient financial support from the federal center
- Underdevelopment of natural resources in backward regions
- Corruption

These factors have caused aggravation of regions' differentiation in social and economical development due to unequal allocation of production factors and personal income. Global imbalance increases budget threats for Russian regions, since toughening sanctions against certain parties of economic intercourse and whole sectors of the Russian economy and the financial infrastructure can significantly affect the gross regional product volume and reduce regional budget revenues.

Specialists reasonably fear that in 2014 hardly some Russian regions will be able to make ends meet. On one hand this is due to the fact that in each and every subject of the Russian Federation expenses associated with fulfilling social commitments according to the May decrees have drastically grown. It is a known fact that wages of public sector workers have been increased entirely due to regional budgets. At this, almost at the same time federal financial support of all regions was reduced and it became another (and as much important) reason for decline of budget revenues. As of January-September of this year the total volume of transfers has reduced by 8.2% as compared to the same period in the previous year. This factor affected above all economically weak territories republics of North Caucasus and poor Volga regions for instance, Mordovia. So, many Russian regions have faced revenue arrears.

Moreover, some more industrialized Russian regions may be at a real risk of bankruptcy as early as in the next year. The Sverdlovsk oblast can be cited as an example: its underlying deficit can correspond from 43-70 billion rubles. However, specialists state that it is by no means the only subject of the Russian Federation which is on the verge of bankruptcy. The point is that in order to receive federal transfers, regions should prove that their budget gap doesn't exceed the standard value. As a result, regions add to their income projections and don't state the sources. Thus for instance in order to receive 16 billions from the federal budget in 2014, the Sverdlovsk oblast should demonstrate that its budget gap doesn't exceed 15% of its revenues.

So, all these factors caused serious financial imbalance almost in all Russian regions, since their expenses have considerably increased while total revenue has grown insignificantly and not everywhere.

The situation is aggravated due to the fact that according to the estimates of the Ministry of economic development and trade of the Russian Federation as early as in the I quarter of 2014 (by the I quarter of 2013) gross domestic product growth was equal to 0.8%, investments reduced by 4.8% and actual money income by 2.4% as compared to the same period of the previous year. In the face of not quite favorable forecast for the future according to which 2014 will see slowing of the gross domestic product growth up to 0.5%, support from the federal budget is rather a phantasm of a hope.

As on April 1, 2014, structure of the debt of Russian regions was the following: public budget loans and loans from other budgets of the RF budgetary system constituted 27.3%, government stocks 25.6%, credits from credit organizations, Foreign and international financial institutions 40%, government guarantees 7% and other

debts 0.1%. During 2013 a share of high-cost bank loans in the regions' debt has grown from 32.6% up to 39.8% while debt servicing costs has increased up to 22.2%. As on April 1, 2014, regions owed to banks a sum amounted to 702.1 billion rubles. In the face of stagnation of the Russian economy growing debt load of subjects of the RF is a source of growing concern and particularly of the Government of the Russian Federation.

Recently their hope to gain low-interest credits has revived. This refers to an intention of the Ministry of Finance of the RF to reduce budget loan rates for regions making it symbolic and budget (for bank credits substitution) extra 100 billion rubles with appropriate reduction of the rate from 2.75-1% per annum. However, the amount of additional budget loan is not very impressive as compared to the debt payable to the federal budget (equal to 1 trillion 686 billion rubles), since it is almost 17 times smaller.

The center clearly understands that in circumstances where regional budget gaps are growing and "technical gaps" occur more often, the problem of attracting additional sources of funds becomes more and more actual for regions. We have made certain that while recently this problem has been solved primarily by means of budget loans in circumstances of accumulating financial problems, including those of the federal budget, it was decided to change the order of granting such loans.

The idea is that regions should be encouraged to make responsible use of this tool. An offered new mechanism of granting budget loans to regions implies some compulsory conditions.

The first condition is that nowadays it is decided to grant budget loans at the interest of 1/2 of the refinancing rate and amounting to 4.13% as of the current year.

The second condition defines, the term of a budget loan which should not be >30 days. However, the deadline of budget loan repayment is also stipulated November, 25.

The third condition stipulates the limit of a budget loan which cannot be >1/12 of the budget income as of the current fiscal year. Subsidies, subventions and other targeted interbudgetary transfers are naturally dropped.

In 2013, three pilot regions were chosen for approbation of the new mechanism; they were the Kaliningrad and the Saratov oblasts and the Republic of North Ossetia-Alania.

North Ossetia is a part of the North Caucasian Federal District. It is a known fact that the Republic's economy suffers serious troubles. For instance with regard to such a factor as investment attractiveness, it ranks No. 71 and with regard to the gross regional product per capita

No. 74. Things are no better with the credit score, causing serious concern whether the region is able to discharge its debts.

It is well-known that North Ossetia is highly dependent on payments from the federal center and is at the bottom with regard to the quality of living. This cannot but causes serious concern. This is quite, evidently illustrated by figures according to which the region ranks:

- No. 49 with regard to income level
- No. 44 with regard to housing conditions
- No. 63 with regard to infrastructure availability
- No. 55 with regard to safety
- No. 82 with regard to life satisfaction (!)

According to the Ministry of economic development and trade of the Russian Federation, this is the only region where in the nearest future growth of poverty headcount is forecasted. Even now, their income is 1.5-2 times lower than national average. In the estimation of specialists North Ossetia is one of the problem-plagued Russian regions where there is every indication of a serious financial and economical crisis.

The region is one of the most backward with regard to the budget gap index which in 2012 has been over 5%. In the current fiscal year, significant improvements should not be expected the budget of the Republic is planned out with the same budget gap.

The situation with debts is even more complex. North Ossetia is among the regions which are at risk of an actual default, since a share of national and municipal debts amounts to over than 50% of budget income as our specialists have already stated. We would like to remind that in the previous year the government debt of the Republic exceeded the republican income and amounted to 118.4%.

If we look at the data, we will see that within 6 months dynamics of the debt of the Republic hasn't improved and with regard to the volume of the debt (6726471.7 thousand rubles) North Ossetia ranks No. 2 in the North Caucasian Federal District.

In the last December, Government program "Development of the North Caucasian Federal District" for the period up to 2025 (Government Program 35) was approved. It is possible that within its scope some budget problems can be solved. The most serious one is imbalance of the regional budget which causes imbalance of accumulated debts and opportunities for the financial support. The situation gets worse due to reduction of budget income of the Republic caused by dwindling excise duties revenues.

How efficient is the policy carried out by the federal center and aimed at evening financial state of different territories? It is well known that for instance, difference between Moscow and Tuva has been gigantic and this by no means contribute to country's performance as one whole with regard to both transportation and economy.

It is obvious that in the current foreign policy situation (the Ukrainian war, sanctions, embargo) the federal center has no choice but to encourage regions to apply market mechanisms for balancing their budgets for instance, issue bonds or take on loans. It should be said that such market instruments are more effective, since applying them regions' responsibility for results of their budget policy increases. However, it is troublesome that these new debts (taking into account the twilight of economic situation) will be an extra burden for regions which have already accumulated a large number of debts. Therefore, it is greatly disturbing that subjects of the RF will fail to solve the debts problems without support of the federal authorities. Since, it is not yet quite clear how regional authorities will service these obligations and whether their budgets will endure a new load.

Answering this question, it will be fair to say that the federal center can clearly see that in the nearest future regions will have to face some problems when financing increased budget commitments, including those within the scope of the May decrees. So in view of significant expenditure obligations delegated to regions, Russian authorities intend to bring in a set of measures which will allow improving balance of regional budgets, particularly through reallocation of income sources between budgets of RF subjects and local budgets. Thus for instance, standards of personal income tax deduction payable to regional budgets have been already increased by 10%.

Also, forms of interbudgetary transfers directed to regions are intended to be specified. These include grants for securing budget balance, horizontal interbudgetary transfers, restriction of sphere where interbudgetary transfers are effected, toughening requirements to subsidies allocation only by laws (decrees). The offered approach to restrictions also implies changing shares of interbudgetary transfers from 20-10% and from 60-40%.

At the same time, the risk is still high. This is caused by increasing debts of subjects of the RF and municipalities and deterioration in the terms of debts servicing and discharging while tax returns to regions' consolidated budgets reduce. As of today the total subnational debt exceeds 2 trillion rubles, i.e., for the last decade it has multiplied. At this now a days, a conception of elaboration and application of practical enforcement

measures directed against budgetary process parties fringing restrictions of debt policy is not yet implemented.

In the next fiscal year, the Budget Code of the Russian Federation is supposed to see some measures targeted at maintaining balance in budgets of the subjects of the RF, including a range of changes toughening terms of gaining borrowed money which can't be serviced and discharged by means of expected revenues. Debt servicing costs are also supposed to be gradually reduced, particularly by means of their partial substitution by federal budget loans while lowering budget loan charges (Shash and Afanasyev, 2014). At this credit terms will include additional requirements concerning restriction of other borrowings (apart from loans for accumulated debt restructuring). Among other measures targeted at improvement of regional budgets balance are optimization of the structure and the volume of expenditure commitments and efficient policy of revenues management.

At the same time, a number of specialists consider that the extent of budget problem may be a little exaggerated, since not so much the volume of the national debt but its structure and maturity are important. With this regard the German territories, some of which with the debts exceeding annual budget revenues by 200% is often cited. Why is it so? The fact is that their debts consist primarily of bonds with maturity terms of 30-50 years. However, the same can't be said of the debts of Russian regions: most of them have more short terms, only public budget loans are the most long-termed ones. That's why, though the volume of regional debts is rather small (if only compared to international practice) in circumstances where annually 50% of debt burden have to be refunded, there is a risk that the borrowing costs will rise as well as a risk that debt payment peaks will coincide with some negative trends in revenues sphere. The more so because regions rely on such an unsustainable and massive source as profit taxes. It is natural that in the context of higher-than-anticipated growth of recurring expenses regions are still much dependent on federal transfers while having fewer and fewer incentives for development and proficient debt management. All these factors, impoverish budget of Russian regions and therefore some prompt recovery measures should be taken.

It should be stated that now a days in circumstances when social and economical development of certain regions is uneven, traditional forms and methods of economical development support which haven't provided positive result in more favorable period have no chance to success. All the more, so as they will be very difficult to implement at risk of mid-term destabilization of the

Russian economy and budget stability due to geopolitical tension resulting from the events involving Ukraine and in circumstances where investments and economical activity at large continue to decline.

Therefore, a radically new mechanism of regions' economical growth is required. At this, the main directions in eliminating imbalance of Russian regions' economic development should be the following:

- A deliberate national federal and regional policy targeted at searching out new (original) sources of economical growth at their territory
- Formation of favorable competitive environment in the region through creating new industrial clusters in the framework of the import substitution policy
- Development of primary industry in accordance with natural, climatic and resource conditions in Russian regions
- Economically justified use of government support tools for development of small and medium enterprises in primary industry, including food processing industry which can be given renewed momentum for development in the context of food embargo
- Establishment of mutually profitable economic contacts with potential participants of commercial intercourse in other regions of the country (including new ones) and foreign partners

Also, the regional strategies should include measures for monitoring their social and economical development, define targets of government support of priority industrial sectors and propose amount of finance and other sources of development.

**Summary:** Sources the reasons and sources of economic differentiation of regions are established, classification by the level of economic development is carried out them, the inefficiency of traditional forms and methods of economic support is proved, changes in the mechanism of the budgetary crediting are considered, the assessment of efficiency of the policy of alignment of a financial position of various territories pursued by the federal center is given. The measures directed on increase of balance of regional budgets are analysed: offers on redistribution of profitable sources between budgets of subjects of the Russian Federation and local budgets; specification of forms of the interbudgetary transfers sent to regions, including introduction of grants for ensuring balance of the budget, "horizontal interbudgetary transfers", restriction of the sphere of the interbudgetary transfers, toughening of requirements to distribution of subsidies exclusively laws (decisions) on the budget. It is proved that now the high level of the risks caused by increase in volumes and deterioration of conditions of

service and repayment of debt obligations of subjects of the Russian Federation and municipalities at simultaneous reduction of the tax income of the consolidated budgets of subjects remains.

## CONCLUSION

The conclusion is drawn that it is necessary to include actions for monitoring of their social and economic development in regional strategy of development to define target reference points of the state support of the enterprises of priority branches of industrial production to plan the volume of financial means and also other sources of development for elimination of an imbalance in economic development of subjects of federation.

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