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Kudryashova, Ekaterina

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## **Budgetary institutions in the context of budget reform in Russia.**

**Ekaterina V. Kudryashova**

**ev\_kudryashova@inbox.ru**

**kandidat nauk, LL M, docent**

**Lecturer of the Moscow High School of Social and Economic sciences**

**Key words:** budget, budgetary reform, public services, strategic planning and budgeting, result oriented budget allocation

**Abstract:** *The article is devoted to the problem of current stage of budgetary reform in Russian Federation – reform of budgetary institutions. The author gives the understanding of the essence of the budgetary institutions reform and analyses it's context. The delay of the third stage of budgetary reform was caused by crisis of 2008. The financial crisis has negative influence on the implementation of budgetary institutions initiatives.*

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### **1. Overview of the budget reform in Russia**

In the beginning of XXI century the system of public expenditures is viewed as another source of improving financial situation of different countries.

Many expenditure reviews are issued to identify best practices and show expenditure imbalances. Countries all over the world put a lot of efforts in improving the budget process and in particular improving public expenditure management systems. The budget is more and more considered to be a political document setting purposes and policy by the redistribution of finances.<sup>1</sup>

Budget reform in Russia coupled with administrative and municipal reforms and formed the context for the new start of strategic management and planning as a common public management approach in Russia. By means of the reforms Russia

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<sup>1</sup> Lewis C.W. How to read a local budget and assess government performance / Local budgeting. Washington: The IBRD and World Bank. 2007. P. 179 – 209.

is gradually building a modern strategic and enabling state.<sup>2</sup> Although as in many other jurisdictions consistent strategic approach in public management facing financial crisis gives priority to tactic measures for counter-acting crisis.<sup>3</sup>

Reforming budgetary system and constructing an effective system of public finance is a complicated and demanding task. One of the common steps in the context of improving budgetary systems is the reform of budgetary institutions. Reform of budgetary institutions sometimes mentioned as the paramount in improving general public sector performance.<sup>4</sup>

This important reform of budgetary institutions reform is currently in progress in Russian Federation. This stage of general budget reform seems to be the most controversial and time-consuming. Budget reform in Russian Federation included the following steps:

2001-2004 Reform of inter-budget relations (transfers);

2004-2008 Reform of budgetary process;

2010 - present Reform of budgetary institutions system (chain).

Traditionally reforms in Russia follow top-down model and all the three reforms are not exception. In particular the agenda of budget reform started from the central issues and current stage finally covers the actors on the lower levels – budgetary institutions. Once all the levels of budgetary system is reformed and financed according to the new principles the financial policy is finally expected to support the economic growth in Russia.<sup>5</sup>

## **2. Pre-reform budgetary institutions and reasons for changes.**

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<sup>2</sup> Kudryashova E. State Planning and Budgeting in the Russian Federation/ Developments in Strategic and Public Management: Studies in the US and Europe (Governance and Public Management). Edited by Paul Joyce, John Bryson, Marc Holzer. London: Palgrave Macmillan. 2014. P. 197-207.

<sup>3</sup> Shick A. ‘Crisis budgeting’ (2009) 3 OECD Journal on budgeting. P. 1-14.

<sup>4</sup> Shah A. Overview in Budgeting and budgetary institutions. Edited by A. Shah. The International Bank for Reconstruction and Development. The World Bank. Washington. 2007. P.14.

<sup>5</sup> Shokhin S.O. Finansivoye pravo – vremya peremen.// Finansovoye pravo. 2014 № 2 S. 3-5(Shokhin S.O. ‘Financial law – the time of changes’ (2014) 2 Financial law 3-5 ).

Under post-soviet legislation before the third stage of the budget reform budgetary institutions were legal entities with a controversial legal status. According to the article 120 of Russian Civil Code<sup>6</sup> an institution was an organization founded by the owner to conduct administrative, cultural and social, or other functions of a non-commercial character and financed by it in whole or in a part. Institution was liable for its obligation only with monetary assets which were at its disposal. If they were insufficient, the owner of the respective property had to take subsidiary liability for the obligations of the institution. This general rule covered the budgetary institutions.

All the institutions including budgetary had restricted rights to dispose the assets – right of operational management. Institutions could own, use and dispose their assets only within the framework set by the law, in coherence with the purposes of their activity, tasks of the owner of the assets (article 296 of Russian Civil Code). The owner had the right to withdraw the assets at any time from the institution.

Budgetary institutions were financed according to the cost estimations. Although, Russian Civil Code stated that income of institution was at their disposal in fact budgetary institutions were restricted in this respect. Insolvency procedure for budgetary institution was also not clear under Russian legislation.

Such legal entities with inconsistent status were quite numerous in Russia. On April, 1 of 2009 there were 25 287 budgetary institutions of federal level and 30 260 budgetary institutions on regional and local level.<sup>7</sup>

There are a few reasons, usually named for the reform of budgetary institutions system.

First of all previous system of budgetary institutions was formed under different social-economic terms and conditions. Budgetary institutions were quite conservative and operated to certain extent in isolation of contemporary market

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<sup>6</sup> Before the Federal Law No. 83-FZ of May 8, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Improvement of the Legal Status of State (Municipal) Institutions came into force  
<sup>7</sup> Saakyan T. Budzhetnoye uchrezhdeniye: ozhidaniye reformy// Budzhetny uchet 2010 № 2 S.16-21 (Saakyan T. 'Budgetary institutions: waiting for reform' 2010 (2) Budgetary accounting 16-21); *Shashkova A.V. Financial & Legal Aspects of Doing Business in Russia. Moscow. 2011. P.45*

approaches to public governance. The expenditures for the budgetary institutions chain were allocated on the base of fixed estimates and “if the base of spending is taken for granted and new money is simply added, the result is a growing budget”<sup>8</sup>. The principles of efficiency and optimization were not expanded to budgetary institutions.

Secondly, budgetary institutions fell outside of the public management system and planning. Reform was an urgent step to involve budgetary institutions into new management and administration system. Financed on the base of cost estimations budgetary institutions did not provide any feedback which could influence the finance allocation. No goal setting and resource allocation mechanism were applicable to former system of budgetary institutions.

It was ascertained in the Concept of long-term social-economic development of Russian Federation for the period till 2020 that new system of public governance should include strategic planning and result oriented governance, which should be tied up with mechanisms of decision-making in budgetary sphere. Before, many of the problems in preparing a realistic budget arise from the lack of overall budget strategy, lack of strategic role of the government, and the fundamental problem of the lack of clear expenditure policies underlying budget allocations.<sup>9</sup> The reform of budgetary institutions fall within the problem of budget allocation. The old system of budget allocations could not fit in the new reality of social economic and financial strategies.

Third reason for the reform of budgetary institutions was lack of motivation for budgetary institutions to be effective. The notion “public service” and related to it quality of public service appeared only in 2010. Public services are linked with the reform of budgetary institutions.

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<sup>8</sup> Dezhbakhsh T.S.H., and Aranson P. A ‘New Theory of the Budgetary Process’, (2006) 18 (1) Economics and Politics P. 47–70.

<sup>9</sup> Diamond J. ‘The New Russian Budget System: A Critical Assessment and Future Reform Agenda’, (2002), 2 (3) *OECD Journal on Budgeting*, P. 119-147

Budgetary institutions reform is aimed at making them transparent and accountable to public. Transparency and accountability of budgetary institutions is an important part of transparency of budgetary process.<sup>10</sup> Effective management in public organizations in general and in budgetary institutions in particular is based on monitoring of the current performance. Former system of budgetary institutions did not allow effective monitoring of budgetary institutions activity and did not provide necessary management information.

Reform of budgetary institutions in Russia is considered to be the most debatable and unpopular step taken by Russian Government in the context of general budgetary reform. Taking into consideration this unpopularity authorities and obligatory reorganization was preceded by possibility of voluntary changing of status from budgetary institution to an autonomous institution. This possibility was created by the Federal law of 3 November 2006 No 174-FZ<sup>11</sup> on Autonomous Institutions. Autonomous institutions could get more freedom under this law, nevertheless only a few budgetary institutions changed their status.

### **3. The new budgetary institutions in Russia.**

The program method of planning and financing became the underlying basis for the new budgetary institutions.<sup>12</sup> The program method was prevailing in budget process long before the budgetary institutions reform. The consistent application of program budgeting and goal-oriented financing is the fundamental idea of new budgetary institutions chain.

Initially, the reform of budgetary institutions with obligatory change of status was planned for 2008. Global crisis of 2008 made adjustments to the agenda of budgetary reform and reform of budgetary institutions was announced only in

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<sup>10</sup> Kudryashova E. The problem of transparency of state planning in the Russian Federation// Russian law: theory and practice. 2010 № 1 S. 26-41; [Shashkova A.V. Russian specifics of combating corruption. 2015 1\(3\) Kutafin University Law Review p. 51-68.](#)

<sup>11</sup> The Federal law of 3 November 2006 No 174-FZ on Autonomous Institutions, *Sobraniye Zakonodatel'stva Rossiiskoi Federatsii (SZ RF)*, (6 November 2006) No 45, item 4626

<sup>12</sup> Boltinova O.V. K voprosy o povyshenii effektivnosti b'udzhethnyh raskhodov v Rossiyskoy Federatsii // Aktualnye problemy rossiiskogo prava 2014 № 3 S. 342-350 (Boltinova O.V. 'To the question of enhancing the efficiency of budget expenditures in Russian Federation (2014) 3 Actual problems of russian law 342-350.

May, 2010 by publication of the Federal Law No. 83-FZ of May 8, 2010<sup>13</sup> on Amending Certain Legislative Acts of the Russian Federation in Connection with Improvement of the Legal Status of State (Municipal) Institutions. This law created general legal basis for reform and set new types of budgetary institutions.

The law came into force only on the 1 of March, 2011 – nearly a year after it was published. Federal law required a number of acts to be issued by Government of Russian Federation and not all of them were ready even by April, 2011. Therefore, in fact implementation of the law took more than one year as it was planned by the Government.

Another reason for the delay of the reform of budgetary institutions was the lack of official position and legislation on public services in Russia. Legal framework of budgetary institutions reform had to include the law on public services. Such law was adopted only in 2010 - the Federal Law No. 227-FZ<sup>14</sup> of July 27, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Adoption of the Federal Law on Arranging the Provision of the State and Municipal Services. The law defined the state and municipal services as following:

“state service provided by a federal executive authority, authority of a state nonbudget fund, an executive government authority of a Russian Federation constituent, as well as by a local government implementing certain government powers it is vested in under federal laws and the laws of the Russian Federation constituents - operations aimed at implementing the functions of, respectively, the federal executive authority, state nonbudget fund, an executive government authority of a Russian Federation constituent, as well as by a local government implementing certain government powers it is vested in under federal laws and the laws of the Russian Federation constituents performed upon requests made by requestors within the powers established by the regulatory acts of the

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<sup>13</sup> The Federal Law No. 83-FZ of May 8, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Improvement of the Legal Status of State (Municipal) Institutions, *Sobraniye Zakonodatel'stva Rossiiskoi Federatsii* (SZ RF), (10 May 2010) No 19, item 2291

<sup>14</sup> The Federal Law No. 227-FZ of July 27, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Adoption of the Federal Law on Arranging the Provision of the State and Municipal Services, *Sobraniye Zakonodatel'stva Rossiiskoi Federatsii* (SZ RF), (2 August 2010) No 31, item 4179

Russian Federation and the regulatory acts of the Russian Federation constituents for the authorities providing state services;

“municipal service provided by the local government - activity aimed at performing the functions of the local government performed upon requests of the requestors within the powers of the authority providing municipal services, related to local issues stipulated by Federal law No. 131-FZ, dated October 6, 2003, "On General Principles of the Organization of Local Self-Government in the Russian Federation" and the Charters of municipal entities”

Government and municipal services are to be included, respectively, in the Government service registers and Municipal service registers.

Federal Law No. 227-FZ came into force on 30, July 2010 and was followed by the special law on the educational issues – the Federal Law No. 293-FZ<sup>15</sup> of November 8, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Improvement of Regulatory Functions and Optimisation of Rendering the State Services in the Educational Field.

New budgetary institutions are funded on the basis of state task, which is in turn based on the list of public services, rendered by each institution. Without the definition and legal regulation of state and municipal services the reform of budgetary institutions was not possible.

According to Federal Law No. 83-FZ of May 8, 2010 – the legal framework for reform - all the budgetary institutions are obliged to change their legal status and become one of the three types of institutions: autonomous, budgetary (new budgetary institutions) or government institution.

Autonomous institutions are most self-reliant institutions. Autonomous institutions are liable for their obligations with all their assets in respect of which autonomous institution exert rights of operation management, except immovable

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<sup>15</sup> The Federal Law No. 293-FZ of November 8, 2010 on Amending Certain Legislative Acts of the Russian Federation in Connection with Improvement of Regulatory Functions and Optimisation of Rendering the State Services in the Educational Field, *Sobraniye Zakonodatel'stva Rossiiskoi Federatsii (SZ RF)*, (15 November 2010) No 46, item 5918;



property and very valuable movable property, given by the founder or acquired by autonomous institution on the account of founder. Autonomous institutions get state or local task on the basis of open tender. Founder of autonomous institution is not liable for the obligations of autonomous institution. Autonomous institution renders state or municipal services according to the state task.

New budgetary institutions have more restrictions from the founder – Russian Federation, subject to Federation or local authorities. New budgetary institutions have to operate in accordance with the purposes, set in laws, other acts, local acts and charter. New budgetary institutions can not refuse to carry out state or local task, formed and approved by founder. New budgetary institutions are financed by subsidies based on the state or local task. New budgetary institutions are allowed to render services in consistency with purposes of their activity for fee beyond the state and local task. The prices for such services are set by the founder.

Government institutions are not allowed to render additional services besides state task, additional income, if any, goes to the budget. Legal regime of government institutions is designed for those spheres where market conditions are not possible, like in penitentiary system.

*Table 1 Most important criteria for comparing types of new budgetary institutions.*

<b>Criteria</b>	<b>Autonomous institution</b>	<b>Budgetary institution</b>	<b>Government Institution</b>
<b>Financing</b>	Subsidy	Subsidy	On the base of cost estimation
<b>Income from the additional</b>	Income is at its discretion.	Income is at its discretion, but the	Income received goes to federal,

<b>services besides state task</b>		prices for services are fixed by founder.	regional or local budget.
<b>Responsibility</b>	No responsibility of founder	Founder is liable for the obligations of budgetary institution if it does not have enough assets	Founder is liable for the obligations of government institution

In short, the main feature of the new type of budgetary institutions is the approach to their functions as to public services and funding of all types of budgetary institutions according to tasks based on the list of services rendered.

Previously budgetary institutions were funded according to cost estimations and results of their operations were not tied up to financing.

#### **4. The problem of performance measurement and control**

There are three central budget functions, namely management, planning and control.<sup>16</sup> All these functions are performed on the stage of financial resources allocation to the chain of budgetary institutions. However, in the result oriented finance - the current paradigm of public finance – the stage of control and the notion “result” becomes crucial both for the budget resources which are already spent and for further budget expenditures planning.

Russia shares with other jurisdictions the problem of performance measurement for the new types of budgetary institutions. State task for the new

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<sup>16</sup> Schick A. 'The Road to PPB: The Stages of Budget Reform', (1966) 26(4) Public Administration Review P. 234–58.

budgetary institutions has to contain the criteria of measurement of public service quality and quantity. However, as the concept of public services is implemented simultaneously with the reform of budgetary institutions, it became even more difficult to find appropriate measurement for different services.

The most important “strategic” mistake of the reform of budgetary institutions in Russia is that the emphasis is made only on the financial aspects. The main idea of budgetary institutions reform was to improve management of budgetary institutions system installing it in the general strategic management system.<sup>17</sup> This is not clearly stated by the officials and not explained to public. The system of result-oriented budgeting of the public sector is supposed to operate in the context of strategic and enabling state concept.<sup>18</sup>

Change of the way how budgetary institutions are funded and financed is an important but not the only purpose of recent changes in budgetary process. Austerity and cut of funds are to be compensated by the advantages of better managed system and financing tiered up with results. Changes of the budgetary institutions system were mentioned to lead to the better quality of public services and effective allocation of resources.

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Reformers have long viewed budgets as means to represent new ways of thinking about government resource allocation. Jesse Burkhead quotes one midcentury advocate of budget reform saying: “The budget is a psychological device to make people in an

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<sup>17</sup> Kudryashova E. Printsip finansovoy obespechennosti publichnogo planirovaniya v Rossiyskoy Federatsii.// Finansovoye pravo. 2010 № 7 S.11-14 (Kudryashova E. ‘Principle of financial provision of public planning in Russian Federation’ (2010) 7 Financial law 11-14);

<sup>18</sup> Joyce P. The Strategic, Enabling State: A Case Study of the UK, 1997-2007 // 2008 4 (3) The International Journal of Leadership and Public Services 24-36;

administrative organization think”.<sup>19</sup> Although the budgetary institutions reform is still unpopular, it was absolutely necessary because it was impossible to leave an “island” of old-style thinking on public financing of public institutions in the middle of the “market ocean.” It is impossible to have numerous budgetary institutions chain managed on the basis of old principles. It is assumed that reform of budgetary institutions system in Russia is a positive step in terms of better management of public sector and improvement of public finance management, but still it is not very well accepted both by consumers of public services and by employees of budgetary chain.

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<sup>19</sup> Burkhead J. Government budgeting. New York: John Wiley. 1956. P.155

9. Shick A. 'Crisis budgeting' (2009) 3 OECD Journal on budgeting. P. 1-14;
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