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in Transition Economies

LEIBNIZ INSTITUTE OF AGRICULTURAL DEVELOPMENT IN TRANSITION ECONOMIES

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Endogenous Formation of Agricultural Policies in Federal States: The Case of Russia

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Presentation outline

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1. Introduction and motivation
2. Theory with empirical illustrations
3. Conclusion

Introduction

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- **Substantial resources are devoted to support agriculture:**
  - Russia – 0.93% of GDP
  - USA – 0.42% of GDP
  - Australia – 0.12% of GDP
- **In Russia federal support** (1.3% of total budget) **is complemented by regional support** (3.3% of consolidated regional Russian budgets)
- **There is an inherent conflict betwen the federal and regional funding („Moral Hazard Problem“)**

Introduction

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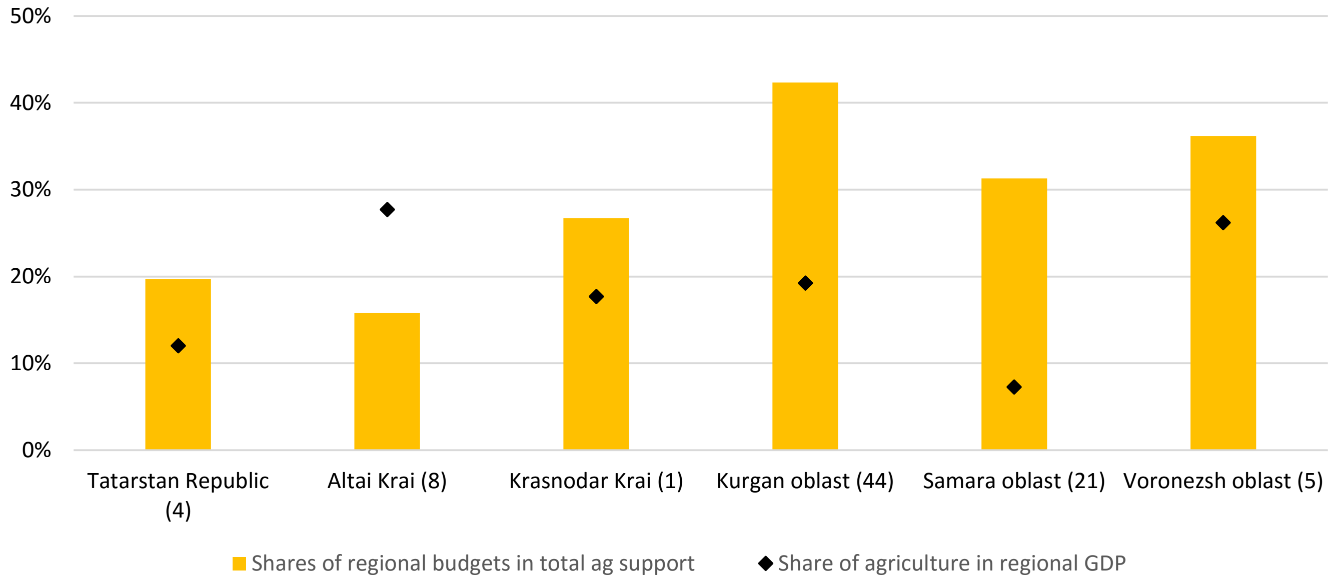
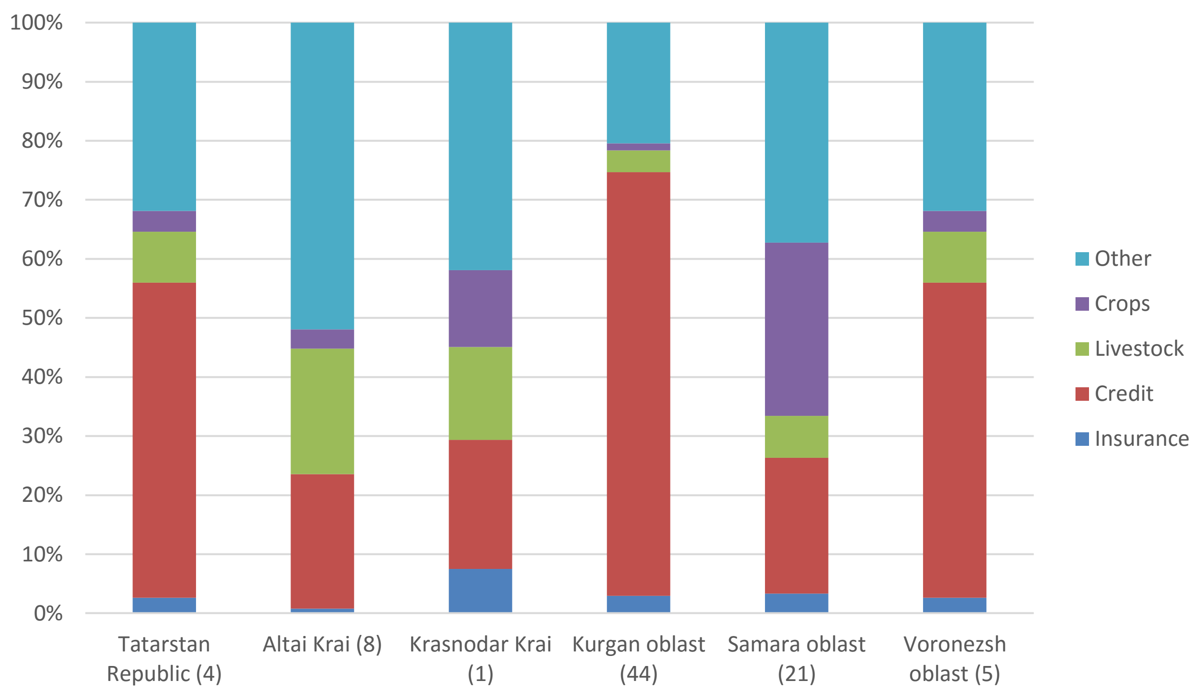
Heterogeneity in regional participation in the support of Russian agriculture



Introduction

Composition of total subsidies to Russian regions



Introduction

Despite recent Putin's centralization reforms, Russian regions appear to be much more autonomous and diverse than expected with respect to:

- Regions' relationship with Moscow and local elites
- Nature of appointed governors
- Population's political preferences
- Degree of democracy within region
- Labor mobility
- Terms of trade with other regions

Source: Zhuravskaya (2010); Marques, Govorun, Pyle (2014); Ross (2010); Nye and Vasilyeva (2015)

Introduction

Yeltsyn period	Putin period
Massive decentralization reforms	Administrative and fiscal centralization (Ross (2010))
Chaotic bargaining with each region over delegation in exchange for political support (“treaties”) (Zhuravskaya (2010))	Appointed governors and regions’ representation is very weak (Ross (2010))
Extreme capture by local elites (Guriev et al. (2010))	Elite capture and intergovernmental bargaining survived but the power was shifted to the federal level (Guriev et al. (2010))
Soft budget constraint (“veksels”) (Ross (2010))	Policies distorting inter-regional trade persisted (Guriev et al. (2010); Zhuravskaya (2010))
Trade barriers bw the regions (Berkowitz and DeJong (1999))	Non-transparent competition for subsidies
Ad hoc intergovernmental transfers (Zhuravskaya (2010))	Just under half of the members of regional legislatures own a business (Reuter (2014))

Introduction

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- Existing theories have limited explanatory power of these regional variations

- Political economy of ag policies is only emerging

- Untapped explanatory power in the literature on federalism, public choice and public economics

Definitions

Federalism: A system of political institutions distributing the power between the central and regional governments

Decentralization: A process of power devolution from the central to regional governments

Goal: To create institutions that minimize government's rent-seeking behavior and generate incentives for fostering economic growth

Objectives:

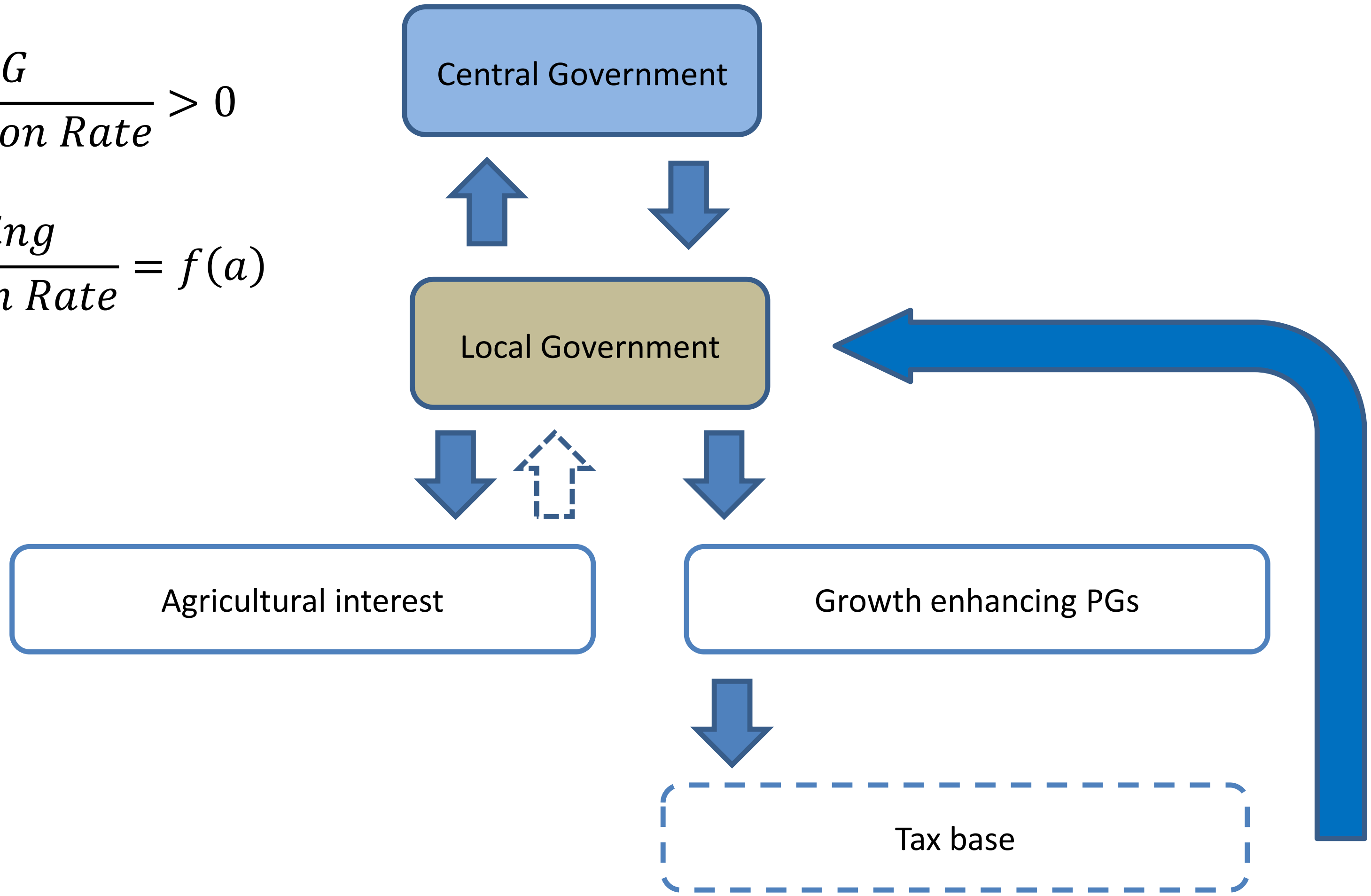
1. Address heterogeneous local preferences

2. Delegate some responsibilities to lower tiers of the government and foster competition

Fiscal Incentives

$$\frac{\partial PG}{\partial Retention\ Rate} > 0$$

$$\frac{\partial Catering}{\partial Retention\ Rate} = f(a)$$



Based on: Careaga and Weingast (2003); Weingast (2009).

Fiscal Incentives

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- **"Fiscal incentives principle":** LGs that raise a substantial portion of their own revenue tend to be more accountable to citizens, to provide market-enhancing PGs, and to be more transparent.

- **High shares of unearned income generate rent-seeking incentives among local politicians:**

→ Federal transfers as a high share of LG's subsidies' budget may intensify rent-seeking incentives

→ Natural resources revenue may detach public institutions from their tax base

→ "Fiscal equivalence": matching those being taxed with those receiving the benefits

Fiscal Incentives

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Important condition:

- Regions have different capacities for tax collection (tax bases)
- A need for CG's equalization transfers
- "Fiscal incentives effect" will diminish as the tax base shrinks and dependence on the CG's transfers increases

Conclusions

Conjecture 1: The elasticity of LGs' ag support wrt federal support should be low in fiscally dependent regions.

or

Ag support should be higher and more stable in fiscally dependent regions and lower in fiscally autonomous counterparts.

Conjecture 2: Higher fiscal autonomy should lead to less capture by ag interests but the effect will diminish with higher share of agriculture in regional GDP

Way Forward

- **Develop a comprehensive model linking inter-governmental relations and the incentives of local stakeholders**

- **Conduct case studies on the extent of LG's capture by agriculture lobby in the selected regions:** Kurgan, Altai, Krasnodar, Samara, Voronezsh, Tatarstan

- **Explain regional expenditures on subsidies with regional data:**

$$SubExpenditure_j = f_j(FedTransfers, ExtIncome, Lobbying, FederalSetup, Controls)$$

Thank you for your attention!

Questions? Comments?