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Consolidation of budget balances: possible risks and ways to minimize them

Regional and municipal liquidity management

Maxim Pershin
Senior Analyst, Sovereign Ratings and Forecasting Group
+7 (495) 139-0480 ext. 104
maxim.pershin@acra-ratings.ru

Elena Anisimova
Associate Director, Sovereign Ratings and Forecasting Group
+7 (495) 139-0486
elena.anisimova@acra-ratings.ru

Contacts for media
Alexey Churilov
Assistant Manager, External Communications
+7 (495) 139-0480 ext.169
alexey.churilov@acra-ratings.ru

Consolidating the funds of regional and municipal budgets onto a single treasury account could allow regions that had previously placed no deposits to generate additional revenue. However, this would reduce interest income for those regions that are currently carrying out these operations.

The Federal Treasury is planning to establish a "large" single treasury account after 2021, which, in addition to the Federal budget and state non-budgetary funds, would accumulate funds from the budgets of all municipalities and subjects of the Russian Federation. In addition, the Federal Treasury plans to manage regional and municipal liquidity. According to Federal Treasury assessments, consolidating funds onto a single treasury account would increase the average daily balance of allocated funds.

How things stand at the moment. As of March 20, 2019, the Federal Treasury placed funds in the amount of RUB 1.1 trln in bank deposits, RUB 0.4 trln in repo agreements, RUB 150 bln in bank accounts, and about RUB 110 bln in order to provide short-term budget loans.

The single treasury account is a set of accounts for Federal budgetary funds opened by the Federal Treasury in the Bank of Russia. The Federal Treasury manages temporarily free funds in the single treasury account in the following ways:

- Placing these funds in deposits of Russian banks in Russian rubles and foreign currency;
- Repo transactions with credit institutions secured by Federal loan bonds;
- Currency swap transactions;
- Placing part of the funds in the accounts of certain systemically important banks;
- Providing short-term budget loans to replenish the accounts of the regional and municipal budgets (in total up to RUB 200 bln at a preferential rate of 0.1% annually).

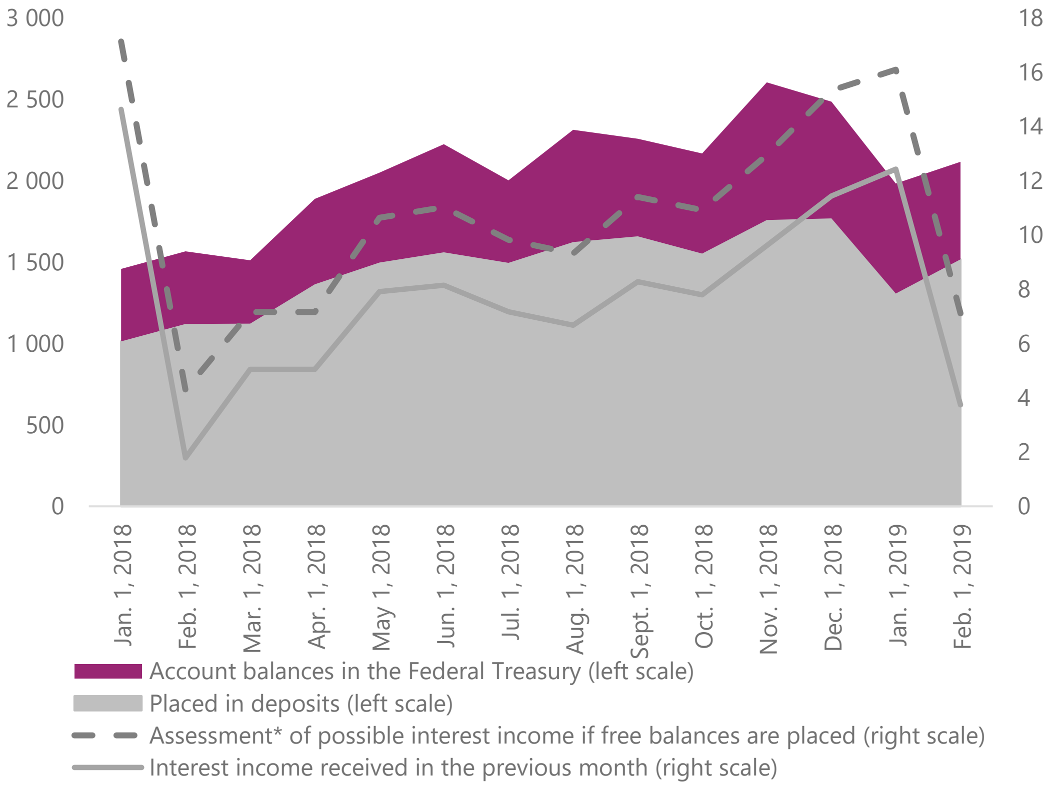
Regions whose budget accounts are open in the Federal Treasury manage their temporarily free funds independently, placing them in bank deposits (subject to the requirements of Art. 236 of the Budget Code of the Russian Federation). Normative legal acts of certain subjects of the Russian Federation, for example, the Khanty-Mansiysk Autonomous Okrug — Ugra, also provide for the execution of repo transactions at the expense of temporarily free budgetary funds where regional bonds are the collateral.

According to our assessments, the total amount of funds placed in deposits by subjects of the Russian Federation is about RUB 1.5 trln as of February 1, 2019. The total revenues of regional and municipal budgets from the placement of budgetary funds in 2018 amounted to RUB 91 bln, exceeding revenues from the management of temporarily free funds of the Federal budget (RUB 86 bln).

At this stage, the details of any future interaction between the Federal Treasury and regional and municipal financial authorities as part of this arrangement have not been disclosed and no regulatory framework is in place.

What the future could hold. The Federal Treasury plans to return to the regions and municipalities the revenues from the placement of their funds. We believe that the main issue here will be in the distribution of revenues received by Federal Treasury between the Federal budget and the regional and municipal budgets.

Figure 1. Temporarily free funds in regional and municipal budgets and revenues from their management, RUB bln.



* Accounting for the placement of balances on Federal Treasury accounts in deposits for up to one month at the deposit rate of the Bank of Russia.

Source: Bank of Russia, Federal Treasury, ACRA's calculations

One way the Federal Treasury is considering returning to the regions and municipalities the revenues from the placement of their funds is by distributing revenues proportional to the balances of the respective budgets.[1] However, this method does not take into account significant differences in the possibilities and conditions of placing federal, regional, and municipal budgetary funds, which can increase the revenues for some budgets and reduce them for others.

Potential problems and possible solutions

The Budget code of the Russian Federation grants the right to place temporarily free funds only to those subjects of the Russian Federation in whose budgets the estimated share of inter-budget transfers from the Federal budget (excluding subventions) over two of the last three fiscal years did not exceed 20% of their own revenues.

1. Only the most financially stable subjects of the Russian Federation have the right to place temporarily free funds in bank deposits according to article 236 of the Budget Code of the Russian Federation. In fact, only 14 regions carried out such operations in 2018. Distributing revenues generated from the liquidity management of consolidated budget could allow those subjects of the Russian Federation who are not currently placing temporarily free funds to earn additional revenue. At the same time, for regions that already generate revenue from the placement of their funds, such a measure could lead to a decrease in budget interest income. This will happen if the share of funds placed by the Federal Treasury in total balances turns out to be less than the share of funds that the region currently places independently.

[1] Shubina L.V. Improving the Management of the Single Federal Budget Account Balances by the Federal Treasury. Economics, taxes & law. 2017;10(1):60-65.

In 2018, the following subjects of the Russian Federation received additional revenues from the management of temporarily free funds in their budgets: Moscow, the Moscow Region, the Tyumen Region, the Republic of Bashkortostan, the Khanty-Mansiysk Autonomous Okrug – Ugra, the Leningrad Region, Saint Petersburg, the Sakhalin Region, the Chelyabinsk Region, the Republic of Tatarstan, the Kemerovo Region, the Samara Region, the Sverdlovsk Region, and the Vologda Region.

Possible solution: Perhaps it would be fairer to allocate interest revenues between the various budgets in proportion to funds, which relevant regions could then independently place as they see fit.

2. On average, the interest rate on the Federal Treasury's placement of temporarily free funds is higher than the rates at which the funds of regional budgets are placed for a comparable period. This difference (a few tenths of a percentage point) is not critical and can be explained by the fact that the Federal Treasury's infrastructure is better known for banks borrowing budget funds for deposits and the regularity of its operations. At the same time, some regions, in particular Moscow, have the opportunity to place part of their temporarily free funds at higher rates and for longer periods (up to six months) than the terms of placement for Federal Treasury funds (usually up to three months). For such regions, the reduction in the terms of fund placement is fraught with lower financial results from the management of temporarily free funds.

   Possible solution: We believe that this problem can be avoided only if the Federal Treasury coordinates the parameters of budget allocation with regional and municipal authorities or allocates regional and municipal budget funds based on applications from these authorities. However, this type of interaction between the Federal Treasury and regional authorities actually means that the Federal Treasury will act as an agent for regional authorities on the allocation of budget funds by providing them with its infrastructure. It involves complex administration and is unlikely to allow the Federal Treasury to pursue a single policy on the liquidity management of budgets of all levels.

3. There is also the question of potentially providing short-term treasury loans to regions and municipalities with funds from the single treasury account to cover cash gaps in the execution of their budgets. Currently, the issuance of such loans from the Federal budget is one of the measures that the Federal government uses to support the regions. When consolidating budgets of all levels, budgetary funds from other regions may be used to provide such loans, which, in view of the preferential cost of budget loans compared to market rates, could reduce the potential revenues of regional budgets, or "liquidity donors." The Federal Treasury using regional budgetary funds this way will essentially act as an additional mechanism for the redistribution of budgetary funds.

   Possible solution: In our opinion, the Federal Treasury should provide short-term budget loans exclusively at the expense of the Federal budget without pulling funds from regional budgets.

4. In some regions, budgetary funds are an important source of liquidity for important regional banks. A lack of access to these funds could have a negative impact not only on the regional banking system, but also on the budgetary system of the region.

   Possible solution: Regional banks will have to compete with major banks for these funds at Federal Treasury auctions. However, this could lead to an increase in interest rates on deposits for these banks.

The Federal Treasury's liquidity management of the consolidated budget will require improved quality in forecasting the cash execution of budgets of all levels, which will help to avoid cash gaps at the consolidated budget level. In turn, this may lead to the further centralization of the budget system of the Russian Federation.

The Federal Treasury's move to manage the liquidity of regional and municipal budgets carries the risk of reducing the flexibility and independence of those budgets. In our opinion, this could lead to a decrease in the profitability of these operations for the most successful regions, which should be considered as a negative factor in assessing creditworthiness. On the other hand, the subjects of the Russian Federation that have a high debt load largely depend on transfers from the Federal budget and are regularly resort to the use of support measures in the form of preferential budget loans. The arrangement developed by the Federal Treasury could provide additional income.

In summarizing the above, we can note that for the regions regularly placing their funds in deposits of Russian banks, the consolidation of their budgets into a single treasury account is unlikely to be justified from the standpoint of both increasing revenues and filling the banking sector with additional liquidity. The voluntary nature of regional and municipal participation in this arrangement would reduce the possible negative effect of this initiative that could occur for some regions.

Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)

75, Sadovnicheskaya embankment, Moscow, Russia

www.acra-ratings.com

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