



**EASTWEST INSTITUTE**  
**REFORMING MUNICIPAL FINANCE OF THE**  
**KALININGRAD REGION THROUGH PERFORMANCE**  
**BUDGETING**

**FINAL NARRATIVE REPORT**  
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## 1 POLICY CONTEXT AND INTERVENTION LOGIC

This report covers the full project period of February 2005 – December 2006.

This project, conducted in by the EastWest Institute in cooperation with the Association of Municipalities of the Kaliningrad Oblast (AMOKO), logically fitted into the ongoing process of Russia's nationwide program of modernization of its budget process management system at the regional and municipal levels in accordance with the best world and European practices. It was designed and launched at the time of large-scale reforms in key areas of government and municipal administration in the Russian Federation, including administrative reform, reforms of local government and budget and urban development and housing legislation. Innovations were largely explained by the federal authorities' drive to streamline the administrative system by delimiting authority between levels of government, uprooting the surviving Soviet perceptions where government plays the predominant role in the country's life primarily in housing and utilities sphere, social support and the streamlining of the administrative systems. All this was meant to lay the foundations for defining new objectives for Russia's public sector and for managing the country's development in general.

In early 2005, regional and local authorities were essentially going through the motions in implementing the above reforms, especially those prescribed for local government such as the territorial reorganization of local government. Inertia for the reform measures was coupled with a lack of serious debate on their implications including the burden of responsibility at different levels of government and on financing of the reforms. At that time, budget estimations for the current year were based solely on the previous years budget without any additional forecasting for increases in expenditure or associated costs. This ineffectual process resulted in municipal institutions remaining committed to the preservation of the underlying system, never reviewing their purpose or goals.

The reform of local government in the Russian Federation and the corresponding reform of the distribution of authority (federal laws Nos. 131-FZ and 122-FZ, passed in 2003 and 2004) paved the way for adjusting the existing budgeting practice. Local government in the Kaliningrad Oblast was confronted with the need to shape its own position with regard to the reform process as a result of the general apathy for change described above. The agenda included a revision of budgeting procedures and a reform of intergovernmental fiscal relations at the regional level for which budget planning to address issues of local importance was a critical feature. Conditions were created for introducing a new approach to the methods of calculating financial assistance amounts. Through analysis of formal and informal decisions on the purposes and targets of expenditures their subsequent cost-benefit evaluation could be used for eventual calculation of subsidies which was meant to even out the budget process, and ensure a sufficient level of funding was available on an ongoing basis. The approach used in the project, corresponded to the ongoing federal-level reform of the budget process and also involved the introduction of performance-based budgeting (PBB). Since law No. 131-FZ revised the contents and substance of municipal authority, political

<sup>1</sup> "Federal Law №131-FZ of September 6, 2003 "On the General Principles of Local Self-Government Organization in the Russian Federation"; Federal Law No 122-FZ of August 22, 2004 introducing amendments to the Russian legislation and providing for transformation of various social benefits and privileges into monetary form.

discussions focused not only on the current municipal functions, government powers delegated from the oblast level, and on those reforms that were to appear from January 1, 2006 on.

The then political system in the Kaliningrad Oblast was based on a checks-and-balances principle, with the governor playing the role of the chief arbiter. Regional-level decisions were the result of chaotic infighting between the relevant parties, such as specialized departments of the oblast administration, the oblast Duma, individual deputies, municipalities and their Association. At the time the project was launched, the Association had considerable power, which in the existing system of regional government enabled it to effectively generate and support change in the region.

Since the regional authorities were not ready to introduce advanced budgeting processes in the oblast, the introduction of the performance budgeting concept in the municipalities was a pioneering venture, one that prepared the ground for broad public support "from below" for the reforms initiated at the federal level. This factor predetermined the formulation of the **principal objective** of the project, **"to form a cumulative public support for a regional finance reform based on the performance budgeting concept"**.

**Key tasks** of the project were formulated as follows:

- 1) Raise the awareness of the municipal finance executives and legislators in the region about the new requirements to the budgetary process at local and regional levels in the context of local self-government reform and the new opportunities it presents for efficient budget management.
- 2) Assist municipalities of the Kaliningrad Oblast in forming a clear vision of their long-term interests in the process of budgetary system reform and in formulating their consolidated position regarding best organization of the budgetary process at local and regional levels as well as intergovernmental fiscal relations in accordance with the principles of PBB.
- 3) Adapt the existing models of PBB to municipal formations needs and to prepare methodological and legislative basis for their approbation in separate pilot municipalities of the Kaliningrad Oblast.
- 4) Provide expert assistance to municipalities, public sector service agents and legislators in the process of drafting regional and local legislation on reorganization of the regional budgetary process and intergovernmental fiscal relations; to assist in developing a favorable legal environment for further efficient integration of performance budgeting methods into the budgetary process organization.

Changes in the political and reform environments in late 2005 through early 2006 made it necessary to reconsider and update the tasks of the project.

On September 28, 2005, the oblast Duma endorsed Georgy Boos as the new governor of the Kaliningrad Oblast. With his ascension, the regional government was drastically restructured, decision-making processes and procedures were revamped, the top management of the regional executive was reshuffled, and relations with the municipalities were rearranged. As a result, the established contacts of the Association and the project in the oblast administration were upset. The

governor introduced a new administrative model, which can be characterized as one based on positive and action based leadership. His key policy line was restructuring of the budget spheres along the principles of a program-based target-specific approach and economic and administrative efficiency. As a result, the oblast government initiated plans to draw up development programs by sector and industry, to systematize and revise existing programs and to make the budget process dependent on programming. Overall it can be said that the new regional policy became the practical embodiment of PBB. This targeted approach, which was converted from a technological system not linked to the substance of objectives and outcomes, produced a de facto instrument of oblast-level planning and administration.

The region's administrative system was completely overhauled in 2006 in order to implement new policies. To this end, the government, elected in March 2006, was strengthened as a collective decision-making body under the governor and the oblast Duma and became the "legislative department" of the government while the municipalities and territorial offices of the federal authorities now came under the auspices of the government as executive branches. It should be noted that the governor, although tending to build a centralized "vertical of authority", is highly competent and efficient, which is a great administrative plus and a guarantee of his leadership. Apart from that, his previous position in the federal government agencies and his role in drafting reformist laws have made him the main source of federal-level information in the Kaliningrad Oblast and has further ensured his success in integrating his own actions into federal plans.

Regional-level processes turned out to be consistent with federal actions: in late 2005 the government launched national projects – initially large-scale national programs that were focused on outcomes and based on grant financing. Their implementation in 2006 drastically changed perceptions of the objectives and systems of government administration in Russia as a whole. At the same time, federal and regional programs, often solely areas of activities which are the domain of local government, forces municipalities to build up their own competences in order to correct actions by superior authorities or to present alternative programs that better meet real local interests. The need to master PBB philosophy and technology has undermined municipalities and their Association with a weakening of their political position. However, it has ensured the municipalities development of new approaches and strategic planning so as to ensure against a further reduction in their power.

It should be noted that a significant turning point was marked by the November 2005 elections of municipal heads and councils of the newly formed municipalities under Law 131-FZ and the establishment in the Kaliningrad Oblast of three districts with urban and rural communities. Before the reform the Kaliningrad Oblast had 22 municipalities and after it the number increased to 36, including 19 urban okrugs, 3 municipal districts and 14 urban and rural communities. As new entities they raised the question of their integration into the municipal community and stated their independent position, in particular, on their relationship with the regional authorities.

On October 12, 2005, Federal Law 131-FZ, On the General Principles of Organization of Local Government, was amended to institute a transition period in the reform process until January 1, 2009 and to empower constituents to independently determine the timeframe for the full-scale enactment of the law. The Kaliningrad Oblast decided (by Oblast Law No. 678 On Procedure for Resolution in 2006 of Issues of Local Importance on the Territory of the Communities Newly Formed on the Territory of the Kaliningrad Oblast of November 22, 2005) that Law 131-FZ should

take effect on January 1, 2007, and by 2006 the newly formed communities were given some of the powers under the act. They did not have independent budgets, but were instead financed out of the budgets of the municipal districts. The change had a double effect on the project because, on the one hand, it delayed the reform process and on the other, it provided additional time to addressing issues of local significance in a cooperative process with the communities in question.

Although the municipalities have been integrated to a considerable degree into the regional government system led by the Governor, encouraging them to formulate independent positions with regard to their functions and budget policies is still relevant. The first reason for this is that they cannot be 100 percent subordinate to the regional authorities because the municipality heads are elected and the second is that individual municipalities uphold active and independent positions, demonstrating that trust and harmonization of objectives and working methods could be a more efficient way of coordination between the two levels of government than through administrative orders. A debate in the region on these problems was provoked by the oblast government's decision to draft a resolution on assessing the efficiency of municipality heads in the fall of 2006. The debate exposed, among other things, the limitations of the government's programmatic approach: the initial draft resolution focused on more visible tangible results and economic efficiency, but ignored issues of the region's long-term comprehensive social and economic development, including the development of its administrative and business environment.

In the fall of 2006, changes in approaches to development objectives in the Russian Federation became visible at the federal level. In particular, one key idea promoted by Moscow was the development of the innovation economy as opposed to the earlier proclaimed and advanced priorities of the oil, gas and power sectors. Vladislav Surkov, the presidential administration's leading ideologist, formulated new approaches to government administration in an article published by the Expert magazine (November 23, 2006). In particular, he criticized both the oligarchic and the centralized bureaucratic system of government and suggested the following: "We must build the basis of an innovation culture, a system for the creation of unique knowledge because knowledge is power and capital for preserving the people both today and in the post-oil age, the onset of which is inevitable. We must convert the raw materials economy into an intellectual one in order to pave Russia's way to the top, into the future, into the community of the creative nations which shape history." This approach, if consistently implemented, presupposes a drastic revision of Russia's traditional governance mechanisms, namely, a transition from "defense competitiveness" and centralized bureaucratic mechanisms to the principles of government based on such concepts as "civic solidarity," cultural diversity, education and a "creative estate."

At a time of consolidation of Russia's political elites within the leading party, United Russia (of which Georgy Boos is one of the leaders), such statements from the federal center send an explicit signal to regional politicians that the direction of movement is shifting. The Kaliningrad Oblast is no exception. But the regional government, although willing to advance in the direction indicated by the Federation, is coming up against a number of difficulties explained by the need to revise the oblast development objectives (based on quick return on investment) and forms of work (currently relying on centralization and rigid top-to-bottom discipline).

All those shifts in the political context reaffirmed the relevance of the general goals formulated under the project. However, in spring 2006, it was necessary to adjust the logic of actions and thematic priorities. In particular, the decision was taken to shift emphasis from problems of

intergovernmental fiscal relations to the discussion and implementation of PBB in a practical way. As a result, theoretical discussions on PBB were put aside in favor of a substantive debate on development prospects for the oblast, its strategic objectives and ways of achieving them, and the elaboration of concrete and realistic concepts of functional operability.

In 2006, the project key tasks were finetuned and formulated in the following way:

1. Development of municipalities' perceptions of PBB methodology and their ability to use primarily its substantive and target-related aspects.
2. Modeling of a new interpretation of public expenditures and development of PBB tools. Analysis of the readiness of individual public finance sectors for the introduction of PBB ideology and tools.
3. Formulation of the municipalities' position on the new interpretation of public expenditures and the related budgeting reform (with regard to both the process and tools).
4. Identification and promotion of best practices of local government in the Kaliningrad Oblast as tools of program target-specific budgeting.

In terms of advocacy and networking intervention logic, in 2006 the project focused more on establishing working cooperation with the regional government agencies (Ministry of Finance, Ministry for the Development of Territories and the Ministry of Education), with less attention to activities at the Oblast Duma. A positive change in the regional authorities' approach was acceptance of AMOKO leaders and experts to participate in regular regional government sessions with a possibility to openly voice their concerns and suggestions.

In summary, the project's contribution could be generally described as pursuing two key objectives:

- Mastering of reforms, powers and federal and regional trends and introduction of municipalities to the new reality;
- Supporting best practices in public sector management on the local level and complimentary development of the concepts of powers and functions as a way of practically introducing results-based management in the territory.

During the last period of implementation (July-December 2006), activities of the project were specifically focused on:

- Dissemination of project outcomes.
- Preparation for publishing project materials.
- Evaluation of project results
- Development of ideas for project follow-up proposals.

## 2 ACTIVITIES AND OUTPUTS

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### 2.1 FORMING MUNICIPAL POSITION ON SELF-GOVERNMENT POWERS IN THE FRAMEWORK OF FISCAL REFORM

This work proceeded in thematic working groups that participated in seminars and worked in-between formal project events. The working groups included relevant specialists from municipalities and from the regional administration including municipal financiers and politicians (heads of local councils), and federal experts. The following meetings were organized as part of this work:

- 5 seminars of the working groups (25 participants) to review the implementation of local tasks and compliance relating to the powers of self-government reform,
- Meetings of the working groups (10 participants) to prepare proposals on changes to legislation regulating education and social support reform,
- 2 seminars of the working groups (9 participants) to review existing practices and prepare proposals on correcting budgeting forms as target programs and subventions (transfers for the performance of the delegated state functions),
- 1 meeting of a working group (4 participants) to review existing development and function performance practices of the budget with follow-up and preparation of analysis materials,
- Meetings of the working groups (10 participants) with representatives of settlements to develop function performance concepts addressing local issues.
- Conference on "Budgetary Instruments to Stimulate Social and Economic Development of the Territory: Modern Trends and Approaches" (February 9, 2006, 55 participants).

The following major results came out of these activities:

- **Municipal functions:** performance and budget development practices in Slavsk District, one of the municipalities of the region, were reviewed. Additionally, a detailed review of local issues in accordance with Law No. 131-FZ and other related legislation was undertaken, which laid an the analytical framework for evaluating current decision-making practices related to the performance of municipal functions in the Kaliningrad Oblast. Municipalities have developed a negative attitude to the traditional financing of budgetary institutions, based on a relative calculation of subsidies. At the same time, this allowed municipalities to be better prepared for discussions on intergovernmental fiscal relations at the regional level.
- The detailed study of the use of subventions, the transfer of state powers from the regional to the municipal level and the implementation of regional target programs led to a change in municipalities' attitude to their budgets. As a result, municipalities began looking at their local budgets in a holistic way linking revenues and expenditures. The most explicit evidence of this change of attitude became the new practice of negotiating subventions between municipalities and the regional government and the further calculation of subventions in connection with definitions of specific state powers transferred to municipalities from the regional level. This change demonstrates an important first step in implementing PBB principles in intergovernmental fiscal relations.
- Federal budgetary reform trends and requirements were reviewed and disseminated, and Municipal positions on the reform of the regional system of intergovernmental fiscal

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relations were detailed, resulting in amendments to the regional Law "On Inter-Budgetary Relations".

- Municipal politicians and finance executives obtained the necessary knowledge about federal housing and urban development legislation reform and further received an opportunity to contribute actively to the discussion and implementation of new provisions in legislation at the regional level.

The development of municipal positions on budgetary and structural reforms was reflected in a number of official documents, the most significant of which are:

- Draft laws and draft amendments to the regional budgetary legislation (see below the list of legislative results of the project);
- Recommendations of the conference, "Budgetary Instruments to Stimulate Social and Economic Development of the Territory: Modern Trends and Approaches" requiring economic assessment of municipal powers and introduction of PBB methods into local and regional management practices;
- Report on the work of the Kaliningrad municipal Association in 2005-2006, approved by the AMOKO General Meeting on April 28, 2006. The report outlines the goals of the project and connects them to municipal positions promoted in the course of the year.

## 2.2 ASSISTANCE TO IMPROVING THE REGIONAL BUDGETARY PROCESS:

This work proceeded in several ways:

- 2 training seminars (27 participants) for municipal officials on budgetary legislation and intergovernmental fiscal relations,
- 2 training sessions (46 participants) for municipal officials on PBB theory and practice, as implemented at the federal level,
- 2 meetings (7 participants) of a working group to prepare and introduce changes to the regional law "On Intergovernmental Fiscal Relations" and a related review of budgetary legislation,
- Meetings of the Association's Board, participation of the Association's representatives in sessions of the regional Duma and meetings of its relevant committee to promote the Association's initiatives to change the system of intergovernmental fiscal relations,
- A review of regional budgetary practice and participation of the Association's representatives in the meetings of the regional Duma's committees and sessions of the regional Duma to correct regional draft budgets in parts pertaining to inter-budgetary relations,
- 1 seminar (11 participants) with relevant working groups on the course of the Association's current work and its cooperation with the Ministry for the Development of Territories in order to develop PBB tools (best practice, municipal development fund).

- Participation of the project experts in cooperation with the regional Ministry for the Development of Territories, in developing an approach to evaluating the financial status of municipalities and setting up a program for the development strategies in selected municipalities (Ozersk and Gurievsk Districts).

The following **legislative results** were achieved due to these events and work with experts under the project:

- 1) Municipal recommendations and draft amendments to the Law "On Intergovernmental Fiscal Relations" were prepared and promoted as legislative initiative. The draft amendments provided municipal suggestions for the following legal procedures:
  - Establishment of ratios of proceeds from regional taxes to local budgets.
  - Establishment of ratios of proceeds from federal taxes to the regional and local budgets.
  - Creation of the regional fund for financing of settlements (or delegating this power to the district level secured by an appropriate subsidy).
  - Creation of the regional fund for financing of the districts.
  - Setting up a procedure of granting subsidies from both above mentioned funds.
  - Setting up a calculation method for additional proceeds replacing subsidies for selected municipalities (established in accordance with the recommendations of the Federal Ministry of Finance).
  - Methodology and calculation procedure of budget sustainability and setting up an appropriate methodology for calculating subsidies to municipalities.
  - Creation of the regional compensation fund.
  - Setting up a procedure for calculating, transfer and recovery of subventions from regional compensation funds.

These amendments were taken into account in a new version of the law prepared by the regional Finance Ministry (passed by the regional Duma and endorsed under No. 74 on November 15, 2006). The new version of the law guarantees greater transparency by introducing a formula-based description of calculations. Although the revision elucidates specific measures and definitions, it fails to address one important issue -- a mechanism for determining the size of funds to support municipalities.

The project did not directly address the legal issues of fiscal reform at the district and settlement (rural) levels. The necessary changes were in most cases applied independently by municipal authorities almost automatically according to regional law and instructions.

- 2) The Law "On the Budgetary Process of the Kaliningrad Oblast" was amended to provide for greater transparency in the budgetary process and an increase in the role of municipalities in the process. The project, jointly with the chairman of the Budget Committee, V. Frolov, the author of the legislative initiative, prepared changes to the schedule of the regional budget

and formalized mechanisms for obtaining municipalities' approval for preliminary estimates of budgetary relations.

- 3) Amendments to the regional Law "On Education" were prepared to better reflect the powers of municipalities and streamline the system of education and the relevant governing bodies. The law was prepared by the regional administration. The project/AMOKO working group prepared amendments regarding: a) the introduction of an enlarged list of municipal powers in the field of education, b) the introduction of the notion of preschool and additional education, c) the introduction of an article on social guarantees to teachers. The amendments were necessitated by the fact that the initial version of draft law addressed only general education and regional institutions, thus violating the integrity of the system of education in regional legislation. Most of these amendments were approved by the regional legislators and included into the approved version of the law (#50 of 12 July 2006)
- 4) A method was developed for calculating subventions and relevant amendments were made to the regional law (adopted on December 28, 2005) on the transfer of social support functions to municipalities.
- 5) Proposals were developed on regional housing standards for lower income persons and the rules of granting the status to a low-income person (regional Law No. 617 of June 29, 2005 "On the Procedure of Recognizing Citizens as Lower Income Persons for Deeming Them Eligible to Housing from the Municipal Housing Fund under a Social Lease Agreement"). The project working group cooperated, within the Association's framework, with the regional administration's legal department to prepare the law and organized a joint meeting with the council heads to develop an informed position on municipal standards for the provision of housing under social lease agreements.
- 6) Amendments to the Kaliningrad Oblast's Law No. 631 of July 11, 2005 "On the Provision of Housing and Utilities Tariff Discounts to Certain Categories of Citizens" were prepared, submitted and adopted in order to introduce additional categories of recipients for benefits and their appropriate financing. This helped to streamline the system of regional benefits to public sector workers living in rural areas.
- 7) New approaches were developed to evaluate efficiency in the terms and standards of municipal heads. The first version of the resolution "On the Evaluation of the Efficiency of the Heads of Municipalities" was discussed by the regional government in November 2006 and held the heads of municipalities responsible for the implementation of regional programs and the complete performance of their functions. Government and working group discussions, which involved representatives of the Association, changed the approach to efficiency evaluation and based it on the evaluation of performance at addressing local issues. The resolution is currently being finalized, after which it will be submitted to the government in its new version. The powers-related efforts undertaken as part of the project in 2005 through the spring of 2006, played a vital role in the work on the resolution by providing for an in-depth discussion of indicators used for evaluation of performance.
- 8) Proposals were developed on wage and staff size limits for municipal officials. Law 131-FZ requires regional authorities to establish wage limits for municipal officials. The initial version of the regional law limited the salary of a junior municipal administration consultant to 2,500 rubles. Debates on the law are ongoing. The Association is taking an active role in

preparing the draft. The most radical suggestions have been rejected. The general principles of determining the rate have been agreed upon between the government agencies involved and AMOKO and this will be endorsed after consideration by the regional government.

In some cases the project was not directly involved in the development of regulatory acts, but the approaches it formulated did affect decision making in one way or another. The idea of developing budgetary service standards, part of the project, was included by the regional Finance Ministry into the Regional Program for Reforming of the System of Public Finance Management of the Kaliningrad Oblast in 2006-2008 (adopted by the Oblast Government on November 8, 2006).

The project produced the following results in terms of providing municipal officials necessary **knowledge and skills**:

- Municipalities were familiarized with the PBB system used at the federal level (as well as with strategic planning and administrative reform issues). They are now familiar with the main procedures, stages and tools, and have been tested on these areas through a simulation game in some municipal activities. After reviewing Swedish municipalities' experience of using PBB, the project described the main PBB models and their correlation with other users as well as providing concrete examples of usage. This created an initial theoretical framework for the development and use of relevant practices in the region among municipal users.
- Concepts of municipal powers were developed. However, their implementation mechanisms have not yet been set in place, which will require further organizational efforts to implement successfully.
- In cooperation with the Ministry for the Development of Territories, a new approach to evaluating the financial status of municipalities and a program for the development of depressed territories was elaborated and tested in Ozersk District in 2006.
- Participation in the process towards a development strategy for Guryevsk District allowed AMOKO and the Kaliningrad Oblast's Ministry for the Development of Territories, which helped in the work on municipal strategies, to assess the current state of strategic planning at the municipal and regional levels in the Kaliningrad Oblast and prospects for Guryevsk's development in the short term.

### **2.3 ANALYTICAL SUPPORT.**

The project expert team provided analytical support to the project activities under items 2.1. and 2.2., primarily focusing on:

- Analysis of international and Russian experiences of applying performance budgeting techniques at the municipal and regional levels, and, making recommendations on a model for introducing performance budgeting at municipal level in the Kaliningrad Oblast.
- Assisting in building concepts for the execution of local powers laid down in new federal legislation on self-government; analysis of best international and Russian practice in this area and of basic modern concepts and methods of organization of executive powers.
- Analytically supporting municipal initiatives regarding draft laws in the process of reforming regional and local public finance in the Kaliningrad Oblast.

In the course of these activities eight working papers and 14 policy papers were produced and distributed among municipal and regional decision-makers in the Kaliningrad Oblast. The nine most significant have been selected for publication in the collection of the project materials, to be printed by MAKS-PRESS Publishing House (Moscow).

#### 2.4 PROJECT RESULTS DISSEMINATION AND ENSURING SUSTAINABILITY OF MUNICIPAL DEVELOPMENT IN THE KALININGRAD OBLAST.

Major project events with the focus on dissemination included:

- 1) The conference, "Budgetary Instruments to Stimulate Social and Economic Development of the Territory: Modern Trends and Approaches" (February 9, 2006), was held as part of the work to disseminate the project's interim results. The conference involved top officials (the chairmen of the councils of deputies and heads), municipal specialists (financiers and economists) from 12 urban areas and districts, and four settlements, as well as officials from the regional Ministry for the Development of Territories and Cooperation with Local Authorities (total of 55 participants).
- 2) The roundtable "Strategic Planning, Budgetary and Administrative Reforms in Russian Regions: Is the Kaliningrad Oblast's Experience Unique?" included participation from federal experts (Moscow, November 24, 2006). Current territorial governance reform projects in Russia were discussed, and an overview of a public finance reform project in the Kaliningrad Oblast was presented. 10 experts participated in the event including:
  - Olga Kuznetsova, Studies Leader, Institute for Regional Politics
  - Artem Shadrin, Head of Department of Social and Economic Development of the RF Ministry of Economic Development and Trade
  - Yuri Kuznetsov, Senior Expert of the Russian Academy of Economy and Fiscal Policy Center (Moscow)
  - Igor Pilipenko, Senior Expert of Economic Faculty of the Moscow State University and Director of Economic Programs of 'Delovaya Rossia', a leading Russian Business Association.

Materials from the meeting were distributed to a wide audience of leading Moscow-based experts in fiscal policies and territorial development.

- 3) The roundtable "Performance Budgeting in the Kaliningrad Oblast: A Case for Russian-European Regional Development Dilemmas" was held in Brussels on December 12, 2006. The results of the project were presented to leading EU experts who are involved in drafting regional development policies and technical assistance programs for Eastern Europe and Russia. Eight European experts, outside of EWI, participated in the meeting representing: the EU Commission - Cabinet of the Commissioner for External Relations and European Neighbourhood, DG Relex, DG Aidco, Permanent Representations of Germany, Poland and Lithuania to the EU, Centre for European Policy Studies and SIDA.
- 4) The seminar "Regional Development Strategies in the Southern Baltic Region" was held in Mikolajki, Poland, December 14-16, 2006. The application of management-by-objectives

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principle to budgetary processes in municipalities necessitated the incorporation of financial issues in the public administration sector into a broader context. This application was related to the selection of a regional development model as a necessary initial element in planning territorial development and budgetary management. International regional ties warranted this selection much more for the Kaliningrad Oblast than for most of other Russian regions. This led to the holding of a seminar in the final stage of the project to compare regional and municipal development strategies within the Kaliningrad Oblast with the strategies of its closest neighbors and to work out concepts for practical international projects aimed at creating a common space of cooperation in the Southern Baltic macro-region. The seminar involved municipal and regional officials from the Kaliningrad Oblast (including Deputy Mayor of Kaliningrad Yuri Galagurski, and Head of Border Cooperation Department of the Ministry for Development of Territories Viktor Romanovski), Klaipeda's Regional Development Agency (Lithuania), representatives from Polish neighboring municipalities (Varmino-Mazur Gmina and Elblong City) and the project experts (24 participants in total). A valuable debate took place on existing approaches to regional development strategies in different parts of the Southern Baltic region, management-by-objectives was discussed as a tool for building territorial development strategies (including the dissemination of information about the results of the EWI/AMOKO project). Additionally, proposals were formulated on the joint study of elements of coordinated strategies for territorial development in the region. The seminar was preceded by an Internet-based discussion of invited representatives involving an even broader number of participants from Russia, Poland and Lithuania.

Furthermore, Vladimir Ivanov presented results and outcomes of the project at a round table discussion "Enhancing Methods of Regional Development Programming" in Moscow, October 31, 2006. The round table brought together leading Moscow-based experts on regional development planning and presented recommendations to the Federal Government on improving programmatic coordination between Federal and regional levels.

Selected materials of the project were prepared for publication under the title "Municipal Finance Modernization in the Kaliningrad Oblast: Management-by-objectives and Regional Development". Edited materials have been submitted to MAKS-PRESS Publishing House and 200 copies are to be published in mid-March 2007 (in Russian and in English).

In order to bring the results of the project to the broader public, the AMOKO Chairman Alexander Grigoryev and members of the working group on intergovernmental fiscal relations participated in the television program "Pozitsiya" on VGTRK Russia-Kaliningrad (August 5, 2005), where the municipalities' proposals regarding intergovernmental fiscal relations (shifting the focus to cost-effective management) were presented.

The project's efforts to secure the future sustainability of PBB and management-by-objectives approach in the Kaliningrad Oblast resulted in the following start-ups:

- Discussion of best practices made it possible to formalize and start implementing two projects under Interreg IIIb/Tacis BSR "Ecology and Energy" and "Regional Economic Development", based on the selection, dissemination and development of the best practices.

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- The project's proposals to create a Municipal Development Fund were discussed by the AMOKO Directorate and the Ministry for the Development of Territories; the minister's report was presented to the Oblast government in January 2006; however, the idea of creating the fund was accepted only in part and is still pending.
- Experts of the project contributed to discussing and formalizing support to the Regional Program for Reforming of the System of Public Finance Management of the Kaliningrad Oblast in 2006-2008 (adopted by the Oblast Government on November 8, 2006). The Program was supported by AMOKO and submitted to the RF Ministry of Finance as an application for competition under the Federal Fund for Regional and Municipal Public Finance Reform. In any event the Program, if implemented consistently by the regional authorities, can prove be an important source of promoting and funding PBB efforts at the municipal level.
- A concept of differentiated approaches to municipalities developed within the framework of the project was accepted by AMOKO as its official policy to help avoid regional authorities' overall negative attitude to municipalities. Several "flagship" municipalities have been identified to pursue further efforts in the practical implementation of PBB and other territorial development strategies, which are intended to assist in bringing the others up to their level (Kaliningrad, Gussev, Guryevsk, Polesk, Pravdinsk, and Ozersk).

The above-mentioned seminars in Brussels and Poland have also opened perspectives for supporting of future PBB and regional development activities in the Kaliningrad Oblast in the framework of cross-border partnerships in Southern Baltic Region with support of the relevant EU funding.

### 3 MAJOR OUTCOMES

The expected outcome of the project was initially formulated as follows:

“By the date of entering into force of the new law, “On the General Principles of Local Self-Government Organization in the Russian Federation” (January 2006), the municipalities of the Kaliningrad Oblast will possess a clear concept and will be ready to implement performance budgeting principles and techniques.” The corresponding main purpose of the project is “to form a cumulative public support and favorable legal environment in the Kaliningrad Oblast for a regional finance reform based on performance budgeting concept”.

On the whole, and considering changes in the schedule of full power distribution and reform (delayed till 2007), the project achieved its objectives:

- As demonstrated above, public finance reform based on performance budgeting concept was stated as an official position of the Kaliningrad Oblast municipalities.
- The oblast legal and normative\policy environment includes the targeted programming and PBB concepts as their integral parts. It is can be clearly seen through analysis of the following major recently adopted documents:

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- Regional 2007 Budget Law
- Governor's Budgetary Address for 2007
- Law on Intergovernmental Fiscal Relations
- Regional Program for Reforming of the System of Public Finance Management of the Kaliningrad Oblast in 2006-2008 (adopted by the Oblast Government on November 8, 2006).<sup>4</sup>

It is natural that these changes are happening under the strong influence of the Federal Government policies and as a result of the political will of the Governor Boos. However, the project's contribution to these positive developments is considerable: principles of sound budget practices were included into policy recommendations of the first phase of the project in 2003, and at the current phase the projects role was essential in making municipalities an active player in promoting fiscal reforms and also in directly supporting legal initiatives on behalf of municipalities (see above the list of legal documents developed by the project).

- Municipalities have adapted to the new European, federal and regional reality, its key trends and the system of players. They can further visualize and position themselves in a broader than usual context, see new challenges, and set adequate and relevant tasks which is an important condition for a local community to be autonomous, have an active role to play and to become one of the players and centers of development.
- New forms of work, as part of municipal practice, were tested under the project, such as working groups, seminars with experts, and developing legislative amendments. Not only did this provide more administrative tools to the local community but also facilitated the development of collective and associative forms of work that require concerted vision and action.
- Intensive work targeting municipalities' powers helped to identify and advance new leaders in municipalities, who on the one hand set an example of public and political action and increased the collective competence of the municipal community in general, including with regard to the regional level, and on the other hand facilitated the introduction of forms of work based on leadership, and started creating a sustainable network of municipal officials.
- Work within the available powers and the need to develop an autonomous municipal stand on issues, including practical PBB, presented the municipalities' with new perceptions. PBB and management-by-objectives are now regarded by a considerable number of municipalities as a special kind of activity. Notions like "local issues", "budgetary sufficiency", "concept", "acceptable budgetary service quality standards", "socio-economic development", "best practices", "depressed territories", and "trend change" were introduced. This may be viewed as a gradual change in the municipalities' approaches from traditional, budgeted financing and operation "as is" to a purposeful definition of public objectives and their consistent achievement. Some municipalities are applying the principles of budget spending efficiency and public sector goals and performance not only to achieve economic efficiency and work with enterprises to increase local budget revenues, but also to improve delivery to such public spheres as culture, healthcare, and education, where the effect is less obvious and the definition of objectives is often complicated.

<sup>4</sup> These documents in Russian are available upon request

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- One of the most significant results of the project is the introduction of the idea of regional development as a special kind of activity, as self-improvement of a territory/community in a bid to respond to challenges in the changing world. This changes the previously more familiar approaches to territorial management and sets new ambitious tasks to the local community and opens up new prospects for the development of the region.

All these positive accomplishments should not hide the fact that the project failed to fully implement some of its tasks as initially expected:

- Developing and promoting, at the regional level, concepts of municipal powers encountered significant organizational and methodological difficulties. The conceptual descriptions suggested by the project require further and considerably more work in terms of the mechanisms of implementation, including suggestions on the sources of financing, administrative techniques, assessment of expected economic and social effects, and harmonization with regional and federal levels. On the positive side, AMOKO will continue developing this issue and seek the necessary expert and financial resources in the framework of regional and federal development programs as well as a continuation of international funding.
- The project failed to promote an agreement between municipalities and the regional government on introduction into the Law on Intergovernmental Fiscal Relations of the norm on calculation of subsidies based on economic assessment of expenditures of municipalities. However, in a longer-term perspective this issue becomes less critical as cooperation between the regional government and municipalities on the joint programs of public sector development gains in importance for municipal budgetary sufficiency.
- The project was unable to provide all 36 municipalities of the Kaliningrad Oblast with sufficient capacity to autonomously implement PBB as a full-cycle technology, from setting objectives and establishing indicators to institutionalizing the monitoring system of socio-economic effects. However, the project did achieve a high degree of municipal competency to work in the PBB system as set by the regional government, and particularly by the Governor G. Boos. Project events and training on PBB involved officials from all municipalities of the region. However, only five or six of them (Gussev, Guryev, Kaliningrad, Polessk, Pravdinsk, and Ozersk) have enough capabilities and political will to share the ownership of PBB and introduce this system as practically and procedurally under their own control. Complex practical implementation of PBB remains a subject for external technical assistance. But it is important to emphasize that the project created a meaningful demand and capacity to formulate the locally generated terms of reference for such assistance. Training in PBB and management-by-objectives should engage not only finance executives and politicians but also a large spectrum of managerial staff in all public institutions. Two separate plans of activities can be developed in order to fit specific needs of advanced municipalities and the rest of the local community.

#### 4. CONCLUSION: IDEAS FOR THE FUTURE

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Promoting performance budgeting in the regional public finance is based on the assumption that this advanced method will ultimately help to integrate Russian and European business environments in Kaliningrad, while at the same time establish the region as a Russian model for cooperation and partnership between Russia and the European Union. However, this proved to be very challenging. The PBB training raised the project participants' awareness of the need for a development strategy, which affects the financial management practices and their social, economic and political effects. The project also discovered that the Kaliningrad Oblast currently faces a difficult dilemma between competing development models, although this is more pronounced in the surrounding European environment.

Unlike in previous administrations, the new government of the region, formed in the fall of 2005, devises its activities not from a correction of operational situations and the prolongation of the prevailing state of affairs, but through management-by-objectives. This approach presupposes an analysis of the situation in each of the public spheres, the choice of target directives and creation of mechanisms for implementation, including activities and sources of financing. A natural process of formation of the programs of the Government's sectoral ministries and their implementation has been under way since the beginning of 2006. The sectoral ministries regard the region's territory and, accordingly, the municipalities, as an "empty space" for setting their own facilities and undertakings. In accordance with that view the municipalities are treated as the executing agencies for the sectoral programs.

There exists another – not "sectoral," but "territorial" – approach to the territory and the municipalities. Essentially it is that a municipality is seen as a separately operating entity, which consists of:

- A comprehensive vision of the territory (facilities and processes) and the existence of a current plan for the economic and social development of the municipality, including a review of the situation and the setting of overall strategic goals and ways to reach them,
- Designated key thrusts (sectoral as well) and related development programs (including the designation of problems, goals and objectives, mechanisms of implementation, arrangements, financial provision and substantiation, and sources of financing),
- Management of the revenues of the municipality, including tax base development work and accounting for outlays' socioeconomic effectiveness.

Together with technologies of work with human capital (including credibility capital) as an alternative way to create social consolidation as well as with the coordination of objectives between the levels of authority, this approach, and activities that realize and develop it, from the viewpoint of the project constitute exactly the endeavor of "regional development."

We presume that, in the near term, the principal questions/challenges in the development of state and municipal administration in the RF and the Kaliningrad Oblast will be:

- 1) The promotion of management-by-objectives in the municipalities: a comprehensive vision of the territory (facilities and processes) and the presence of a current plan for the social and economic development of the municipality, incorporating a review of the situation and the setting of overall strategic aims and ways for achieving them; the singling out of key

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directions (sectoral among them) and formation of development programs in them (including designation of problems, goals and objectives, the mechanisms of implementation, arrangements, financial provision and substantiation, and sources of finance); and management of municipality revenues, including tax base development related work and accounting of the socioeconomic effectiveness of outlays.

- 2) The development of forms of social interaction: as an example, a special method for constructing arenas (forums) where the suitable partners meet. It is a method of communication and the creation of forums with several levels: information – transfer of knowledge, dialogue, participation, interaction and the formation of new knowledge. The overall goal of the method is attitude change and the promotion of a more coherent approach to matters or problems.
- 3) The formation of a regional system of administration – interaction between the various levels of administration: the coordination of the shaping and pursuit of political aims between different levels of authority so that these aims are shared and adequately reflected in the autonomous decisions of each of the levels, complementing each other; the change of influence due to a formal position (officials) to an influence based on leadership and reputation (state/municipal employees); the coordination of budget flows at different levels to harmonize financing for the implementation of adopted political aims and have them adequately supported in the part of current and long-term financing alike.
- 4) The drawing up and implementation of development programs for individual sectors of municipal activity:
  - - ecological policy,
  - - ecological education,
  - - economic policy,
  - - education,
  - - culture,
  - - guardianship, etc.

From our point of view, the Kaliningrad Oblast, because of its enclave situation, has encountered these challenges earlier than Russia's other regions and can now act as a pilot region in terms of regionalization and regional development in the Russian Federation. The latest moves of the federal authorities suggest that their efforts will soon be proceeding in the same direction.

International and transfrontier cooperation between neighbor countries is a significant priority for the Kaliningrad Oblast. In recent years, this cooperation has evolved from unilateral assistance into a cooperative interaction on the principles of mutual benefit and equal partnership. We hold that the concept of “neighborhood” should not be limited to infrastructure investments, but ought to incorporate the building up of the sides’ understanding of each other, joint planning and the formation of a common mode of the future. This means the interaction of concerned persons on both sides who are seeking answers to the challenges of local and regional development. At the same time, we feel that the international community’s assistance in the development of regional policy and of territorial management based on regional development principles will help to continue the harmonization of the Russian Federation’s interrelationships with the surrounding world.

The project’s natural next phase could be the continued development of the concepts “region,” “regionalization,” “regional development” and their transfer into practice of state and municipal administration in the Kaliningrad Oblast. The tasks of such a next phase are:

- Assess the place of the project-developed concept of regional development in respect to the appropriate theoretical developments and practice in the municipal entities and regional power bodies of the Kaliningrad Oblast/Russian Federation, in the neighbor countries and across the world.
- Determine the substantive points of action to promote regional development activities within the region.
- Determine and start work on the development of substantive public industries that can be included in regional development and which can become the spheres of practical application of the relevant approaches and instruments.

We think that such movement will help create a platform for removal of potential future macro conflicts, since that platform can offer an option for social action other than centralization. And since the Kaliningrad Oblast has experienced the global trend of regionalization earlier than other Russian regions, it is compelled to start addressing this challenge and pave the way for others. The EastWest Institute will continue exploring these issues together with its Kaliningrad-based partners in the framework of EWT’s Conflict Prevention and Global Security Programs (see [www.ewi.info](http://www.ewi.info)).

