

ORIGINAL PAPER



DOI: 10.26794/2220-6469-2021-15-2-6-15
UDC 336.143(045)

Appropriate Budgetary Policy for a Changing Economy

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ABSTRACT

The XXI century's contemporary challenges and crises indicate that fiscal policy is an appropriate tool for countercyclical regulation, ensuring sustainable economic growth and social justice. In this regard, society's requirements for the quality of budgetary policy have changed, which has shifted the focus in setting goals and choosing tools for its implementation from the position of ensuring sustainable economic growth and the principles of fair distribution of income. The analysis allows us to conclude that to ensure the proper quality of budgetary policy, its goals and objectives must correspond to the strategic goals of developing public law education, and coordination of budgetary and monetary policy is necessary. To achieve the goals of justice, the author of the article propose to differentiate the instruments of inter-budgetary reallocation of funds depending on the level of debt sustainability of the regions and to use targeted grants to motivate the authorities of public law entities to ensure sustainable socio-economic development. The article shows that for improvement of the formation mechanism of state programs and national projects and budget efficiency growth, it is necessary to monitor the compliance of tax expenditures and budget subsidies with the target indicators of state programs. **Keywords:** budgetary policy; the proper quality of budgetary policy; objectives of budgetary policy; the economic growth; inequality; tax expenses; budget subsidies; government programs

For citation: Solyannikova S.P. Appropriate budgetary policy for a changing economy. *Mir novoi ekonomiki = The World of New Economy*. 2021;15(2):6-15. DOI: 10.26794/2220-6469-2021-15-2-6-15

INTRODUCTION

Current trends in the development of public financial management reflect, on the one hand, an increase in the number of tasks to be carried out in the process of formulating and implementing public-law budgets, on the other hand, on changing the functions of the State and increasing the level of public demand for the soundness of the directions and the volume of use of budgetary resources and for the availability and quality of State and municipal services, performance of public sector institutions and budget efficiency. For example, as evidenced by foreign and domestic experience, the innovation ecosystem is first shaped around public development institutions, and then an expanding supply comes from private investors. In this context, it is necessary

to formulate a budget policy capable of ensuring, first, the effective use of a limited amount of budgetary resources and, secondly, the maintenance of the potential for the social impact of budgetary policies economic processes.

As a response to these public finance management requirements in academic publications, Codes of Best Practice prepared by the IMF, OECD, introduced the term Good Budgetary Policy (appropriate fiscal policy), to assess the extent to which the goals and objectives of budgetary policies pursued by States are consistent with the principles of good and responsible governance within the framework of the concept Good Budgetary Governance (quality of public administration), increased transparency, openness and

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inclusiveness in public sector financial management.¹ As part of the implementation these requirements, and in the light of current challenges, fiscal policy should focus on the long-term sustainability of public sector finance through risk assessment and the use of budgetary rules, improving budget efficiency.

CURRENT BUDGETARY POLICY REQUIREMENTS

In modern conditions, the key to “macroeconomic health” of the State is fiscal policy, which takes into account the emergence of new macroeconomic risks and is a stabilizing factor of the social and economic development of the State, not an additional source of risks. At the same time, the top priority in fiscal policy is “careful matching of equity and efficiency objectives”.²

In fact, the high level of economic uncertainty, globalization, the changing structure of the world economy have been the main reason for rethinking the role of fiscal policy, as monetary opportunities credit policy as a tool for macroeconomic management has shown its limitations. “The crisis has provided evidence that fiscal policy is an appropriate counter-cyclical policy instrument at a time when monetary policy is limited to a zero floor, the financial sector is weak or the gap between potential and actual production is particularly large”.³

A number of factors are influencing the transformation of modern budgetary policy requirements:

- external, including economic (related to globalization, changing structure of the world economy, high level of economic uncertainty), political (related to the formation of a new social contract between the State and society), social (deepening inequality, failure to fully implement existing social obligations of the State), demographic (changing gender and age structures, migration problems) and technological (related to the development of information and communication technologies);
- internal, associated with (1) the growth of the State, with the decline in the effectiveness of the hierarchical system of democratic governance and the inability to ensure the competitiveness of national economies in the dynamic structure of the world economy, (2) citizens’ dissatisfaction with the quality of public services and the increase in the cost of maintaining the State apparatus, in the absence of opportunities for citizens and civil society institutions to influence State decisions affecting them.

CONCEPTUAL APPROACHES TO DEFINING THE TERM “APPROPRIATE BUDGET POLICIES”

Use of the term “appropriate budget policy” in IMF codes of best practice OECD, policy documents of Russian and foreign public authorities in the context of effective and responsible management of public finances envisages the definition of this concept based on the theory of management complex social-economic systems and public law.

In the research publications [1–8] on public sector financial management and law, an appropriate approach to the management of complex socio-economic systems implies the ability to influence the course of events. Therefore, appropriate budget policies should be pursued as purely financial (linked to increased revenues, increased efficiency of expenditure budgets of public-law entities), thus, the general economic objectives are

¹ Draft principles of Budgetary Governance (OECD, 2013). URL: <http://gogov.org.ua/wp-content/uploads/2016/05/Draft-Principles-of-Budgetary-Governance.pdf>.

² Recent developments and prospects in the public sector. Analytical Report. IMF, 2014. URL: <https://www.imf.org/external/russian/pubs/ft/fm/2014/01/pdf/fmexsr.pdf>.

³ From stabilization to sustainable growth. Annual report / Coll. auth.: under the leadership of D. Hawley, George. Clift, H. Riad. IMF, 2014. URL: <https://www.theguardian.com/society/2018/apr/26/rise-in-child-drug-runners-recruited-from-small-towns-research>.



defined, defining the measures and instruments to influence the national economy and the standard of living of the population. This requirement should be taken into account in defining the objectives, objectives and instruments of fiscal policy in the medium and long term.

Appropriate budget policies in the face of contemporary challenges — it's a government programme that uses government revenues and expenditures to influence macroeconomic conditions to ensure sustainable economic growth and equitable income distribution. Accordingly, appropriate budgetary policies should ensure:

- conditions for sustained economic growth;
- conducting counter-cyclical or cyclically neutral policies;
- access by all economic agents to public goods, implementation of the principles of fair distribution of income and equal access to productive and financial assets, adaptation to the requirements of a changing economy;
- establishment optimal levels and rationally structured public debt, as well as reserves, to ensure macroeconomic and fiscal sustainability under adverse conditions.

This is possible, in author's view, provided that there are clear, manageable budgetary rules and strategic public policy objectives that ensure that citizens, economic agents, understand the current, medium- and long-term policies of the Government.

The proper approach to the design and implementation of fiscal policy in the current situation requires an understanding that budget parameters should not grow faster than an economy. In particular, in countries that are dependent on external economic conditions for their sustainability, cyclical problems arise when revenues from the sale of natural resources increase public spending, creating fiscal momentum. This is the case when budget expenditure trends closely follow natural resource prices, thus reinforcing

economic cycles. Sustainability problems arise when the costs of such countries are greater than their expected long-term revenues from natural resources. This may occur when they extrapolate temporary price increases and therefore assume an incorrect estimate of the value of their natural wealth and (or) do not establish adequate budgetary reserves to maintain current expenditure levels. All of this can lead to the boom and bust cycles so often observed in resource-rich countries. In this regard, the developing and implementation of appropriate budgetary policies should be based on an assessment of the State's ability to maintain current expenditures and to maintain the optimal level of taxation in the long term, without jeopardizing their capacity to pay or defaulting on their expenditure obligations.

A 2006–2012 IMF research shows that lower inequality is associated with greater macroeconomic stability and more sustained economic growth [9]. This means that budget policy-making in the current context needs to focus not only on the efficient use of budgetary resources but also on social equity.

Neither in the State programmes of the Russian Federation (as amended in 2018–2019) nor in the Basic Directions of the Budget, Tax and Customs Tariff Policy of the Russian Federation for 2020 and the planning period 2021–2022 does not link budget spending goals to social concerns under the UN Sustainable Development Goals 2016–2030 (Sustainable Development Goals — SDG), in particular with regard to such issues as those reflected in the 2019 and 2020 index.⁴

The lowest score for Russia, even compared to Belarus and Kazakhstan, is *for Goal 10 "Reduce inequality within and between countries"*. This problem is not being addressed by the fact that social benefits are aimed at achieving a minimum standard of living (including for pensioners), which financed from budgetary

⁴ URL: <https://dashboards.sdgindex.org/#/RUS>.



resources (including State programmes of the Russian Federation and the constituent entities of the Federation), or by the increase in social budget expenditure in absolute terms.

While inequality is inevitable in a market-based economic system, high levels of inequality can reduce social stability, polarize societies and ultimately reduce economic growth.

Investment in education and health can help reduce income inequality in the medium term, address intergenerational poverty increasing social mobility of the population and ultimately — reducing regional disparities and sustained economic growth.

It should be borne in mind, however, that in recent decades, health indicators have been influenced by factors other than health expenditure and health, such as nutrition, education and healthy lifestyles.

Addressing persistent inequalities requires better targeting of budget expenditures, especially in the social sectors (education, health).

The problem of *regional disparities* in terms of socio-economic development is deepening and cannot be resolved by the existing system of inter-budgetary relations. The results of the analysis of official statistical information show that in the constituent entities of the Russian Federation there was no significant change in the level of estimated budgetary provision in 2016–2020, and that the regions with approximately equal levels of coverage — average or higher in the Federal District — per capita GRP and calculated budgetary security, may receive a different amount of equalization grant in 2019–2021 (Tula and Tver oblasts in Central autonomous District, Pskov oblast and the Republic of Karelia in the North-West Federal District, The Republic of Dagestan and the Chechen Republic in North Caucasus North Caucasus, Republic of Mari El and Kirov Oblast in Volga Federal Districts, Khabarovsk Krai and Amur Oblast in Far Eastern Federal

District and others). With the increase in intergovernmental transfers from the federal budget in many regions, income from business activities is declining, and the proportion of social benefits and wages paid to workers in State and municipal institutions is increasing.

METHODOLOGICAL REQUIREMENTS FOR THE DEVELOPMENT AND IMPLEMENTATION OF APPROPRIATE BUDGETARY POLICIES

The rate and level of economic growth are due to the development of real production, the functioning of the financial sector, and the conditions of money circulation. The impact of fiscal policy instruments on each of these elements is significant. On the one hand, the movement of financial resources characterizes the reproductive structure of the real sector of the economy as well as the basis of the financial market, on the other hand, the monetary attribute of the formation and redistribution of financial resources affects the basic elements of money circulation. Accordingly, the choice of appropriate fiscal policy instruments aimed at ensuring macroeconomic sustainability must take into account their impact on:

- level of prices (size and structure of the money supply);
- exchange rate of the national currency;
- interest rate (value of resources) on the financial market;
- the nature of the transfer of value added through the budgetary system.

For example, appropriate fiscal policies can prevent overheating and related problems. Fiscal austerity can help to reduce domestic demand, reduce the need for monetary tightening, and reduce the pressure of short-term capital inflows on the economy, the national currency and the financial market. Consequently, indicators are needed for evaluation: (a) short-term fiscal policy orientation (e.g., whether pro-growth fiscal policies lead to inflation and an increase in a country's current account deficit) and (b)



capacity to pay (i.e. the ability of the State to meet dynamic budgetary constraints at different times).

The global financial crisis 2008–2011 showed that “while monetary policy caused lower volatility and increased liquidity in North American stock markets, shocks were largely domestic and ineffective in generating liquidity in the banking sector. On the contrary, public expenditure shocks have had a positive impact on lending and consumption, particularly in Europe and Canada. In addition, fiscal policies have also had a positive international spillover effect on consumption and credit, especially for small economies such as Canada” [10].

The areas and instruments considered for the impact of appropriate fiscal policies on macroeconomic sustainability are closely interlinked and — therefore — have a multiplier effect on economic processes, which raises the question of the consistency and priorities of budgetary policies, the need to combine the various instruments of their implementation, and coordination with the State’s monetary and tariff policies.

Accordingly, the *conditions* for an appropriate approach to the formulation and implementation of budgetary policies, in our view, include:

1. Conformity of the goals and objectives of budget policy with the strategic goals of developing public legal education.

2. Coordination with monetary and tariff policies.

Monetary and government fiscal policies have different but overlapping objectives. Monetary policy should ensure the stability of the currency, the adequacy of credit resources in the economy, the necessary level of international reserves and stable prices. In this context, monetary policy, like fiscal policy, is aimed at controlling economic growth, controlling inflation and creating employment.

For example, the key to anti-inflationary policies is to strengthen the revenue base

of a country’s budget system and to ensure its balance. In this context, they become relevant: (a) selection of methods to cover budget deficits without inflationary effects; (b) developing and implementing effective tax policies and improving tax collection; (c) increased efficiency of budgets at different levels; (d) development of the State and municipal securities market. At the same time, the level of development of the market for State and municipal securities directly influences the liquidity of banks and the degree of their financial stability.

3. Consistency in the formulation and implementation of budgetary policies, assessment of their medium- and long-term impact.

4. Budget risk identification and management.

5. Development and implementation of budgetary rules in the areas of income, expenditure, mobilization of funds from sources of financing the budget deficit and management of the State (municipal) debt.

An analysis of the budgetary legislation of the Russian Federation shows that budgetary rules are currently established only with regard to the use of oil and gas revenues from the federal budget and the formation of the National Welfare Fund, the size of the budget deficit, the level of borrowing by federal and municipal entities, the size of the state debt of the constituent entities of the Russian Federation and the municipal debt and servicing costs. However, the growing scarcity of regional and local budgets, as well as the number of violations of the rules established by the Budget Code of the Russian Federation by the constituent entities of the Federation, is indicative of a reduction in the level of stability of the budget system and the inadequacy of existing legal provisions to ensure the implementation of appropriate budgetary policies in the execution of the country’s budget system.

HOW TO ENSURE THE QUALITY OF THE RUSSIAN FEDERATION'S BUDGET POLICY?

With low economic growth and increased uncertainty *appropriate budgetary policy should ensure preparedness for possible downturns while maintaining a balance between growth and sustainability objectives, which requires a review of the structure of the federal budget in an inclusive and growth-enhancing manner.* This requires better taxation, more efficient social spending of the budget and active labour market policies, as well as increasing fiscal investment in infrastructure and improving the quality and accessibility of public services in pursuit of the UN Global Sustainable Development Goals 2016–2030 (Sustainable Development Goals — SDG) and national strategic development goals of the Russian Federation for the period up to 2030.

The changing demographic situation, technological progress and the deepening of globalization are creating structural problems. The ageing of the population exacerbates the sustainability of the public pension and health-care system. Technological progress and the digitization of the economy require public financial incentives to create new jobs and modernize public infrastructure, including education and health services and meeting the needs of the population in a rapidly urbanizing environment. Fiscal policy and the structure of budgets must change in a way that is consistent with modern transformations in the markets for goods, services, labour and the sex and age structure of the population.

In the 21st century, with low economic growth and increased uncertainty, fiscal policy must ensure that the federal State's spending obligations are not only met, but also *to reduce inequality (both social and territorial) in the country.* This challenge cannot be ignored, for without the elimination of territorial inequality in Russia, it is impossible to ensure a sustained rate of economic growth, social and financial

stability and a high standard of living for the population.

At the same time, the increase in the volume of intergovernmental transfers (see *table*) does not lead either to a strengthening of the budgetary stability of the constituent entities of the Russian Federation or to a reduction in the level of their socio-economic development [11]. For example, while in 2017 the difference in actual budget allocations between the 10-best-off and the 10-poorest regions was 6,2 times, before grants to equalize the level of budgetary security, and after — 2,6 times, and in 2019—6,6 and 2,9 times respectively (see *figure*). Differentiation among the constituent entities of the Federation persists with regard to the level of GRP per capita, disposable per capita income, unemployment, entrepreneurial activity and other macroeconomic indicators.

Taking into account the uneven socio-economic development of the constituent entities of the Russian Federation resulting from a large number of factors, many of which cannot be influenced by the regions (unevenness of production capacity, minerals and taxpayers, demographic, historical, climatic, cultural, etc. factors) increase risks:

(a) deepening inequality in real income and living standards among the various constituent entities of the Russian Federation;

(b) uncontrolled (especially in view of the suspension of the requirements of the Budget Code of the Russian Federation on the extent of deficits and public debt of the constituent entities of the Federation, in accordance with the Federal Act on 01 April 2020 No. 103), the increase in both budget deficits in the constituent entities of the Russian Federation and loans from commercial banks in the State debt structure of the constituent entities of the Federation. The realization of these risks will consequently increase the burden on the federal budget, which already has limited room for maneuver and for additional inter-budget transfers.

Table

Dynamics of inter-budgetary transfers provided to the constituent entities of the Russian Federation from the federal budget in 2009–2019, billion roubles

Intergovernmental transfers	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Transferred – total, billion rub.	1474.20	1378.30	1470.24	1440.04	1487.95	1606.97	1500.40	1567.80	1690.10	1719.60	2387.20
dynamics over previous year, %		-6.5%	6.7%	-2.1%	3.3%	8.0%	-6.6%	4.5%	7.8%	1.7%	38.8%
Grants, billion rub.	579.80	522.70	563.50	524.48	609.14	783.92	644.00	656.20	758.98	832.00	924.00
dynamics over previous year, %		-9.8%	7.8%	-6.9%	16.1%	28.7%	-17.8%	1.9%	15.7%	9.6%	11.1%
Targeted intergovernmental transfers, including:	704.30	855.60	906.74	915.56	878.81	823.05	856.40	911.60	931.10	887.70	1463.20
dynamics over previous year, %		21.5%	6.0%	1.0%	-4.0%	-6.3%	4.1%	6.4%	2.1%	-4.7%	64.8%
Subsidies, billion rubles.	435.90	411.40	509.17	570.92	515.61	400.65	371.20	356.50	419.81	397.00	556.60
dynamics over previous year, %		-5.6%	23.8%	12.1%	-9.7%	-22.3%	-7.4%	-4.0%	17.8%	-5.4%	40.2%
Subventions, billion rub.	153.20	378.60	337.47	284.21	273.72	308.16	312.80	334.30	326.15	309.30	396.60
dynamics over previous year, %		147.1%	-10.9%	-15.8%	-3.7%	12.6%	1.5%	6.9%	-2.4%	-5.2%	28.2%
Other intergovernmental transfers, bln rub.	115.20	65.60	60.10	60.43	89.48	114.24	172.40	220.80	185.14	181.40	510.00
dynamics over previous year, %		-43.1%	-8.4%	0.5%	48.1%	27.7%	50.9%	28.1%	-16.2%	-2.0%	181.1%

Source: Compiled by the author based on data on the execution of the consolidated budgets of the constituent entities of the Russian Federation for 2009–2019. URL: <https://roskazna.gov.ru/ispolnenie-byudzhetrov/konsolidirovannye-byudzhety-subektov>.

Adequate responses to this challenge can be provided in the design and implementation of good-quality budget policies, supposing:

1. Refinement of regional budget balance tools.

As domestic and foreign experience shows, substituting transfer financing for self-financing of territorial budgets, First, the deterioration of their income structure; second, the underestimation by high-income regions of their own incomes and the reduction of their incentives to expand the tax base; third, it stimulates budgetary dependency on the part of regions with an underdeveloped income base. Moreover, the implementation of a set of epidemic control measures has already led to a reduction in the revenues of taxes on profits and assets of organizations and taxes on personal income to regional budgets.

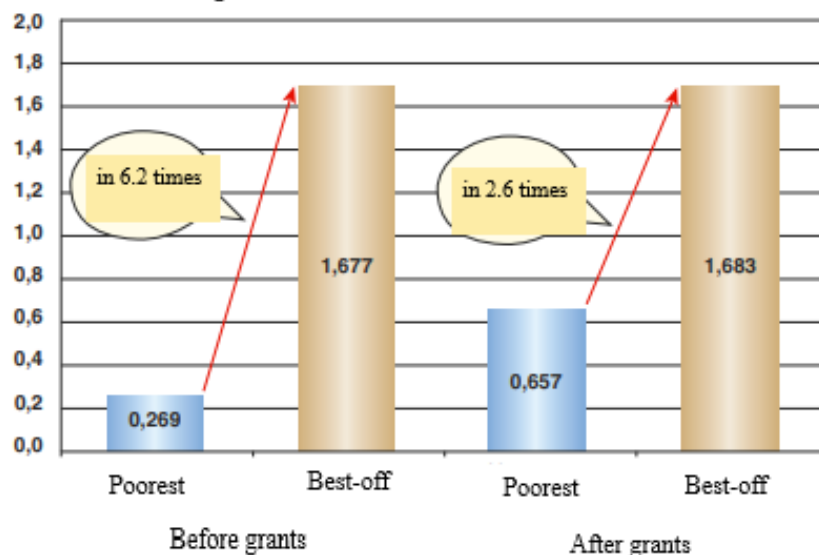
On the impossibility of ensuring the current and long-term balance of regional budgets within the existing system of income distribution, expenditure obligations and budgetary rules are reflected in the growing number of violations by the constituent entities of the Russian Federation of the requirements of the Budget Code of the Russian Federation with regard to limits on the amount of borrowing and the cost of servicing the State debt of the constituent entities of the Russian Federation in 2014–2020.

Replacing market debt with budgetary credits does not solve the problem of increasing the debt sustainability of the constituent entities of the Russian Federation, only by making debt servicing cheaper.

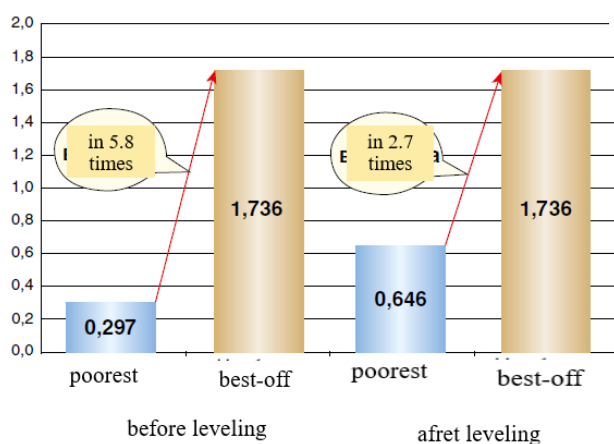
Targeted financial assistance can be a solution for regions with low debt sustainability, and for

Difference in actual budgetary provision of the constituent entities of the Russian Federation in 2017 between the 10- Best-off and the 10-least poorest regions

Before and after the granting of grants to equalize the budget of the constituent entities of the Russian Federation and grants to support measures to ensure balanced budgets of the constituent entities of the Russian Federation



The difference in the level of calculated budgetary security of the constituent entities of the Russian Federation in 2019 between 10 best-off and 10 poorest regions



The difference in the level of actual budgetary provision of the constituent entities of the Russian Federation in 2019 between 10 best-off and 10 poorest regions

Before and after the granting of grants to equalize the budget of the constituent entities of the Russian Federation and grants to support measures to ensure balanced budgets of the constituent entities of the Russian Federation

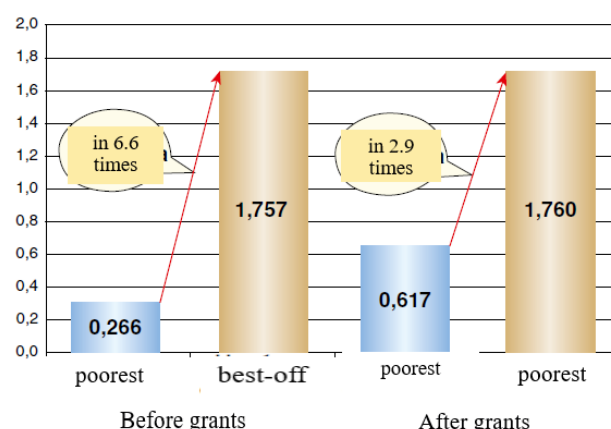


Fig. Dynamics of the Level of Budgetary Provision of the Subjects of the Russian Federation

Source: compiled by the author based on data on the execution of the consolidated budgets of the constituent entities of the Russian Federation for 2019. URL: <https://roskazna.gov.ru/ispolnenie-byudzheto/konsolidirovannye-byudzhety-subektov/>.

other groups of states — provision of long-term budgetary credits for up to 10 years to balance the maturity and maturity of regional debt. For regions with budget revenue less inter-budget special-purpose transfers falling by more than 10%, it's possible to resume the practice of granting budgetary credits for a period of 5 to 10 years, provided that a strategy for the socio-economic development of the constituent entities of the Federation and a plan for improving its income-generating potential are developed and successfully implemented. A grace period on credit may be a motivational tool when neither interest on the loan nor principal is paid.

2. Use of a system of targeted grants based on the evaluation of the results achieved by public-law entities to motivate public-law authorities to ensure sustainable social and economic development.

A further challenge in the design and implementation of budgetary policies can be seen as the need to observe the principle of a *clear direct link* between tax expenditures and the expected results of the implementation of the State (municipal) with a *minimum level of influence of other factors*, which should be included in the general requirements for the estimation of tax expenditures of public-law entities.

At present, the financial support of the State programmes of the Russian Federation *doesn't always take into account tax expenditures in relation to the envisaged programme activities and expected results*. For example, in order to create conditions for the accelerated development of the Far East and its transformation into a competitive region with diversified economies, a set of tax incentives for participants in regional investment projects was introduced in 2016, of which — special tax projects. However, the State Programme of the Russian Federation “Social and Economic Development of the Far East and Baikal Region” doesn't include an assessment of tax expenditures on designated tax preferences,

nor does it reflect the contribution of tax relief to the programme's objectives and objectives, as well as the expected results. In this context, *the risk of inefficiency of tax expenditures is high, which is not identified and assessed*, thus rendering formal and unjustified the “linking” of tax expenditures to the State programmes of the Russian Federation and the constituent entities of the Federation.

Assessing the effectiveness of public law tax expenditures also requires a reliable and sufficient statistical base with quantifiable significant correlation relationships over a period of at least 10 years, which doesn't always exist at present, it is therefore necessary to start building an information base for such assessments.

Inconsistency between the objectives of budget subsidies and the objectives (targets) of State programmes and the results of subsidies in the agreements persists. For example, according to the federal project “Export of products of agro-industrial complex” the indicator of the result is the achievement of the volume of exports of products of agro-industrial complex (in comparable prices) in the amount of 34 billion USD by the end of 2024. At the same time, within the framework of the provision of a subsidy to reimburse Russian credit organizations for lost revenues on loans issued to agricultural producers at a preferential rate, the result is considered to be the amount of concessional short-term (investment) credits granted to borrowers with a competitiveness agreement per ruble of the grant. However, the increase in loans does not mean that production is increasing, let alone exports.

The result of the granted to Russian manufacturers of wheeled vehicles to offset part of the cost of maintaining jobs is that the recipient maintains the average monthly wage of employees in the enterprise for the fiscal year under review not less than the average monthly nominal wages of employees for the fiscal year in question for the full range of organizations

in the federal district of the Russian Federation, where the recipient arranges the manufacture of vehicles. However, the objective of the “Transport and Special Machinery Development” subprogramme is the development of high-tech and competitive domestic and foreign production of Russian transport and special engineering equipment with high value added and localization of the most critical technologies and components, with the

establishment of a performance indicator in the form of a production index relative to the previous year. There is no direct correlation between the maintenance of workers’ wages and the growth of the production index.

This makes it necessary to further improve the mechanism for formulating State programmes and national projects with a view to increasing budgetary efficiency.

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The article was received on 15.03.2021; revised on 30.03.2021 and accepted for publication on 15.04.2021. The author read and approved the final version of the manuscript.