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## **Methods of State's Reaction to Risks of State Finances Management**

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**Abstract:**

*The purpose of the article is the study of methods of state's reaction to risks of state finances management. Methodological basis of the research is presented by the principle of integrity of the past, present, and future, with the help of which the proprietary position for determination of the category of state financial reserves in the basis of F. Knight's concept is presented, according to which measurability of uncertainty is one of prerequisites of formation and use of financial reserves. A key conclusion of the conducted research is substantiation of the fact that, being an economic category, state financial reserves occupy a certain niche in the system of state finances. From these positions, state financial reserves are financial relations as to creation, distribution, and use of the part of national financial resources that are created from value added (GDP) and are aimed for constant process of development of national economy under the conditions of uncertainty and risk. Under the modern conditions, the necessity for clear work of national institutes that coordinate state financial flows grows. Evaluation and distribution of risks in this sphere of management and use of methods of regulation of risks in any moment can be measured quantitatively and determined qualitatively only after their implementation later on.*

**Key Words:** *Management Risks, State Management, State Finances, State Financial Reserves*

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**JEL Classification :**

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## **1. Introduction**

It is difficult to overestimate importance and responsibility of management of state finances, as effectiveness of this management influences well-being of population of the country and perspectives for further growth and development of national economy. In the globalizing economy of the world, except for internal risks, the process of management of state finances is influenced by external risks, which complicates this process even more.

Reduction of uncertainty and increase of stability of management of state finances require the use of risk management instrumentarium. This determines the topicality of the study of methods of state's reaction to risks of management of state finances, which is viewed in this article.

## **2. Method**

Modern financial management determines state financial reserves as a special form of state financial resources which are subject to separate accounting and management and characterized by individual methods of accumulation and spending of assets, as stock of state income and postponed state income. All economic theories consider the main reason for creation of financial reserves to be constant financial provision of reproduction process due to uncertainty of development of economic processes, both at macro-level (state) and micro-level (enterprise, husbandry).

The most significant contribution into development of modern ideas on management of state finances and financial reserves was made by the following scientists: (Demirmen, 2013), (Zhou, 2009), (Rockoff, 2015), (Morelli *et al.*, 2015), (Vortelinos, 2014), (Hayo *et al.*, 2014), (Carpenter *et al.*, 2014), (Kohn, 2013), (Bassetto & Messer, 2013), etc.

Despite the high level of elaboration of the problem of the research, there is still certain fragmentarity of study of the issues of risk management in financial sphere at national level. That's why there is a need for systematization of existing knowledge in this sphere and generalization of information on the methods of reaction of the state to risks of state finances management.

## **3. Results**

There are also other reasons for formation of financial reserves which depend on the strategy and tactics of economic subjects, but the latter's taking from their revenue a part of financial assets in the form of special reserve stock, which perform the role

of self-insurance, gives them possibility to organize a constant process of financing even during the periods of delays of income flow or its substantial reduction.

In our opinion, for the theory of formation of state financial reserves, the Knight's concept could be applied, according to which risk is measurable uncertainty, or probability of event evaluated by any method, while uncertainty cannot be evaluated and cannot be objectively or subjectively measured. Measurability of uncertainty is one of prerequisites of formation and use of financial reserves (Knight, 1921).

Under the conditions of uncertainty, parameters of implementation of management of state financial flows "income-expenses" (including of state budget) can be various, so the state (authorized bodies) can provide their evaluations. Some measurements could be considered insignificant, as they do not influence at all or influence slightly the result of functioning of state economy. Other changes can be viewed as significant and ones that damage the economy. Thus, the risk could be viewed as sub aggregate of uncertainty, as possibility for emergence of conditions that are unfavorable for national economy. That is, the notion of risk is subjective, for if there is uncertainty, it is for all national economies; the same change of conditions could be evaluated by the state as significant and negative, or as insignificant and positive.

In most theories before Knight, during study of conditions of balance in economic system, profit in the break-even point was equaled to zero. This meant that under the stable state of economy, there is no place for profit, and only interest on capital is possible (Klark, 1899). Analyzing mechanisms of profit creation, Knight showed that profit could emerge in stationary state. If the results of his theory are taken to macro-level, it is possible to conclude that in sustainable balanced position, state economy can have the excess of state income over expenses, i.e., positive financial result.

Taking into account such approach to risk, let us determine such notions as "subject of risk of state finances management" and "object of risk of state finances management". The subject is administrative machine (institutions) of state financial resources management which makes decisions as to formation and spending of state finances (President of the RF, Government of the RF, State Duma, etc.). Correspondingly, the object is a certain indicator that could be changed in case of emergence of risk situation.

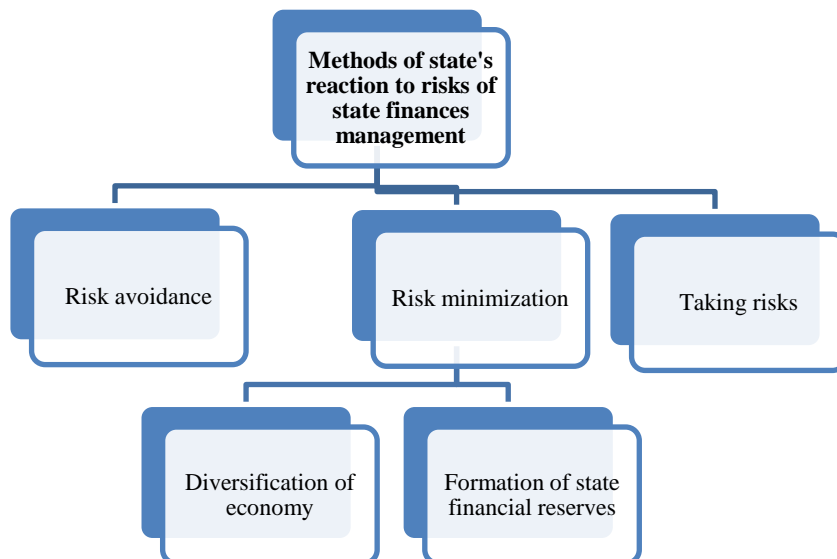
Taking into account the fact that we view the situation with ongoing development of state economy under the conditions of non-deficit, this indicator, in our opinion, is the indicator of financial result (difference between state income and expenses over certain period (as a particular case, applicable only to state budget, a profit of budget can be viewed as this indicator).

Thus, it is possible to give the following definition to the notion of risk of state finances management: risk is quantitatively measurable probability of significant (from the point of view of subject of risk) deviation of results of functioning of state economy from planned values, caused by uncertainty of conditions (external – global and internal – national) of development of economy.

Economic science determines three groups of subjects' reaction to risk: risk avoidance, risk taking, and risk minimization. Using this terminology for state finances management (sustainability of state financial system), it is possible to conclude the following. First type of reaction to risk is an example of "closed" economy (economy of North Korea is a vivid example of this; economy of Russia at the time of NEP). Such type of reaction to risks is the most radical; it allows avoiding potential losses related to changes of foreign economic situation. On the other hand, national economy of such country does not develop with rates that neighboring countries have achieved.

Second type of reaction is taking risk; it can be done not by all national economies and, as a rule, it emerges in inevitable situations. Third type of risk minimization is related to such methods as diversification of economy, or methods that become very popular nowadays – formation of state financial reserves and funds. All these types of reactions to risk are economic.

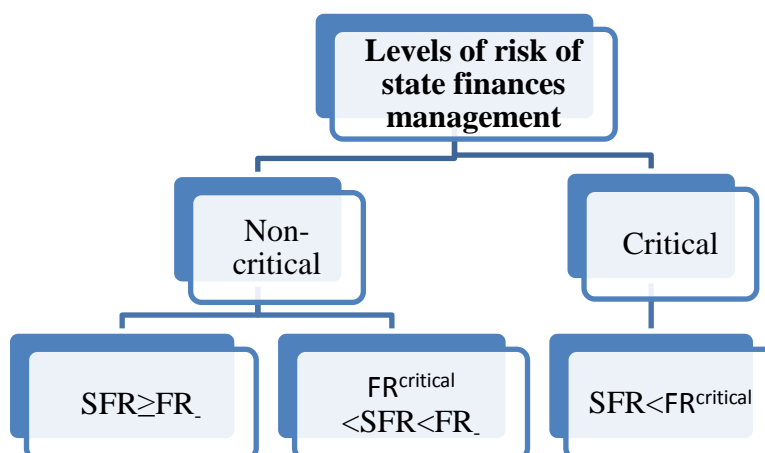
Figure 1 – Methods of state's reaction to risks of state finances management



It should be noted that in the process of formation and use of state financial reserves, it is possible to distinguish the following peculiarities:

- main purpose – creation of conditions for stability of national economy (source of profit in the form of capitalization of interest income is not the main goal);
- redistribution of current and expected state financial flows in time;
- risk is eliminated partially (it's impossible to fully eliminate it), to non-critical level; at that, critical level of risk leads to such negative financial result at which it is impossible to quickly restore national economy without attraction of significant loaned assets (default situation).

Figure 2 – Levels of risk of state finances management



\*SFR – state financial reserves,

FR<sub>-</sub> - negative financial result for the period,

FR<sup>critical</sup> – critical level of negative financial result for the period

Strategy of development of state and its position in the global economy set peculiarities of the system of state finances risks management. Applying the basics of the theory of risk management, which are peculiar for micro-level, to macro-level (Popkova *et al.*, 2015a), it is possible to determine the following interconnection: methods of formation of national financial reserves are determined by state's strategy and chosen variant of risk management (Table 1).

**Table 1. Interconnection of strategy of state’s development and corresponding variant of risk management**

State’s strategy	Variants of risk management
Acquisition of new direction of economic development	Risky
	Cautious
Preservation of sustainable financial position	Cautious
	Wary

Source: compiled by the author

Risky variant supposes availability of large financial reserves; cautious variant of risk management is characterized by formation of financial reserves of certain sizes, sufficient for expected level of risk; wary variant is characterized by accumulation of insignificant resources. Accepting the strategy of preservation of sustainable financial position, the state forms financial reserves and, thus, pursues the following aims (Popkova *et al.*, 2015b):

- supporting the process of functioning of national economy;
- stability of money flows (state income and expenses);
- positive result of functioning – in long-term perspective, financial result should be positive (excess of income over expenses (as individual case – budget’s profit));
- growth of national economy (growth of GDP);
- other aims (e.g., socialization of economy).

Generalizing the above, it is possible to formulate main provisions which characterize the sense of state financial reserves on the basis of development of risk theory and uncertainty of F. Knight and concept of minimization of risk of state finances management.

1. The source of formation of state financial reserves is value added (GDP), which has to be created in excess of that which is necessary for expansion of national economy.
2. State financial reserves minimize risks of state finances management to non-critical level, at which economy can quickly restore without attraction of significant loaned assets from outside.

3. Methods of formation of national financial reserves correspond to the chosen strategy of development of national economy.

4. Use of mechanism of state financial reserved in long-term perspective should ensure positive financial result (excess of national income over expenses with continuous growth of GDP).

#### **4. Conclusion**

Thus, being an economic category, state financial reserves occupy certain niche in the system of state finances. From these positions, state financial reserves are financial relations as to creation, distribution, and use of the part of national financial resources that are created from value added (GDP) and are aimed for continuous process of development of national economy under the conditions of uncertainty and risk.

Economic and political global processes require from state managers constant attention to the problems of analysis of external and internal factors which determine effectiveness of functioning of state economy. In many countries, including Russia, risks that influence sustainability of national economies and methods for their neutralization are studied.

Nowadays, there is growing necessity for ordered work of state institutions which coordinate state financial flows. Evaluation and distribution of risks in this sphere of management and use of methods of risk regulation in any moment can be quantitatively measured and qualitatively determined only after their implementation later on. As the global practice shows, one of the ways of protection from such risks is creation of effective system of state financial reserves.

At present, any state faces necessity for reduction of uncertainty and risks in the process of economic development. The task of creation of the system of protection from unforeseen situations in the state economy, which is related to reserving of financial resources, becomes actual, which – in general economic sense – means their preservation in stock and distribution in time.

Applicability of state financial reserves, as a tool for reduction of financial risks, could be shown with the help of analysis of evolution of the notion “state financial reserves” from the point of view of general economic and financial problems of functioning of state economy.

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