




REGIONAL

DEVELOPMENT

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HAMAZASP GALSTYAN

PhD in Economics, Senior researcher at Amberd Research Center of Armenian State University of Economics

 <https://orcid.org/0000-0001-9014-5892>


GAGIK BADADYAN

PhD Student of the Chair of Management at Armenian State University of Economics

 <https://orcid.org/0000-0001-6026-6204>

KRISTINE TATOSYAN

PhD Student of the Chair of Management at Armenian State University of Economics

 <https://orcid.org/0000-0003-4593-3747>

INTERRELATIONS OF MUNICIPAL AND STATE BUDGETS IN THE REPUBLIC OF ARMENIA AND THE IMPACT OF BUDGET PROPORTIONS ON REGIONAL ECONOMIC DEVELOPMENT

The implementation of the state budget designed by the central government bodies in each country aims at improving the socioeconomic condition of the country and solving the existing problems related to that condition. The differentiation of the levels of socioeconomic development of territorial units is quite important. Disparities in territorial development are characteristic of all countries in the world, but it is another matter that the degree of these disparities can be significantly different for different countries. Regardless of the degree of disparities, the central government bodies of countries try to distribute budget funds in such a way that it is possible to overcome the disparities of territorial development, or at least reduce them to a minimum level. The relations between the state and local budgets are of essential importance in that process, when a part of municipal budget revenues is generated due to these relations.

In this regard, the Republic of Armenia is not an exception, and there is an objective need to study the relationship between the budget revenues of the municipalities of the Republic of Armenia (in the form of the regional total) and the development level of the regions.

Keywords: *territorial development, disproportionality, state budget, municipal budget, subvention, dotation*

JEL: H61, H72

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INTRODUCTION. The existence of regional development disparities is an objective reality for all countries of the world, which practically no state can avoid. In the case of the Republic of Armenia, regional development disparities are also present in the case of the regions, and there are many studies evaluating these disparities. These disparities reach a rather high level at the regional level, and the financial mechanisms for overcoming them are mainly within the framework of local-state interaction. In this case, there is a need to study to what extent the relationship between the municipal and state budgets contributes to overcoming the disparities of territorial development in the RA. To get an answer to the mentioned question, the article compares the levels of socioeconomic development of the regions of the Republic of Armenia and the total budgetary, own and state budget revenues of the municipalities included in the regions. *The purpose of the conducted study is to reveal the degree of correlation of the financing volumes allocated from the RA state budget to the municipal budgets with the level of socioeconomic development of regions. This correlation should be at the maximum level because a strong expressed connection will mean that the state uses the relationship between the state budget and the municipal budgets to give proportionality to the territorial development. Observations were carried out by comparing quantile groups and calculating the correlation of indicators.*

LITERATURE REVIEW. Budget formulation is one of the main policy tools of public administration in every country (Lienert and Jung, 2004, p. 3), which implies that it should outline the current government's view of the country's socioeconomic status and its future (Shah, 2007, p. 180). One of the most important components of the socioeconomic condition of the country is the degree of territorial development disparities, which implies the presence of inconsistencies in economic, social, political, cultural, and environmental conditions at the regional level (Pike, Rodriguez, and Tomaney, 2006, p. 256). In that context, it is important what the budget structure is like and how much it contributes to overcoming regional development disparities.

Local budgets are significant in ensuring the integrated development of the territory and raising the standard of living of citizens (Altaibayeva, Kurmanova, Soltangazinov, and Mutallyapova, 2018). So, the importance of the opportunities for territorial budgets to ensure the desired territorial development

is very high (Beran, Teichmann, Kuda, and Zdarilova, 2020). The opportunities of local budgets directly depend on the relationship with the state budget, because higher budgets are allocated to disadvantaged regions' local budgets according to a regional development level (Center for Mediterranean Integration, 2019, p. 24). However, what those processes are like in the RA is another question, and the article aims to fill the gap in this regard.

In the RA, the problems of territorial development intersect with the opportunities of local budgets within the framework of the five-year plan of community development. Based on the five-year plan of community development, the planning of the necessary financial means for solving the problems of community importance is carried out to ensure annual budget inputs and outputs (Schanyan, 2018). Moreover, one of the four main sections of the community development program is the financing of the development program itself (EDRC, 2022, pp. 9-10).

Allocations to municipal budgets have their share in the structure of the state budget expenses, which can directly affect the disparities of territorial development. In the RA, the relationship between the state and municipal budgets implies revenues from the state budget in the municipal budgets. These revenues can be included in the municipal budget in the form of dotations and subventions (Law of the Republic of Armenia on the budgetary system of the Republic of Armenia, 1997, article 27) according to the following directions:

1. financial equalization dotations, free and non-refundable funds to cover the costs of municipalities,
2. other dotations, funds given free of charge and non-refundable, not related to the implementation of any type of expenditure (a program), to support the financing of the budget expenses,
3. subventions, funds given free of charge and non-refundable for the implementation of a specific target type of expenditure (a program) carried out by the community (Law of the Republic of Armenia on the budgetary system of the Republic of Armenia, 1997, article 20).

By its nature, a dotation is a way of financing, when the municipality can manage the provided free financial resources independently and determine the directions and goals of their use because the purpose of the dotation is simply to alleviate the difference between the expenditures and revenues of the municipal budgets. As mentioned, dotations are provided either on an equalization basis or in the form of other dotations. Naturally, the dotations are mostly composed of the dotations provided on the principle of equalization. Financial equalization is the reduction of the existing differences between the financial capabilities of the municipalities to promote the harmonious development of the municipalities, as well as to create an opportunity to make the minimum level of expenses in all municipalities, so it will be possible to implement functions of local self-government bodies (Law of the Republic of Armenia on the financial

equalization, 2016). The aim of this financing mechanism is also the mitigation of regional development disparities. However, whether this financing is carried out in the right way and the right amount depends on the actual financing volumes.

Unlike a dotation, subvention funding is targeted and allocated only to finance specific projects. In this case, compared to dotations, the Government of the Republic of Armenia has the right to claim back the non-targeted used amounts of subventions allocated to the community (Law of the Republic of Armenia on the budgetary system of the Republic of Armenia, 1997). However, let us note that subvention is provided only based on program applications submitted by the municipality (Government decision on approving the procedure for providing subsidies to communities from the state budget of the Republic of Armenia, 2006), which implies that they do not derive from the national policy of overcoming regional development disparities, but from the demands of the municipality and the management capabilities of local self-government bodies.

However, it should also be noted that a draft on making amendments and additions to the RA Law "On Financial Equalization" has been developed in the RA, with which improvements are planned to a certain extent in the discussed directions of financing (Unified Website for Publication of Legal Acts' Drafts, 2023).

In this case, there is a need to understand to what extent the relationships between the state budget and municipal budgets in the RA contribute to overcoming the disparities of territorial development.

RESEARCH METHODOLOGY. The main methodology used to obtain results within the framework of the article is *the comparison of quantile groups*. Comparisons were made between the following groups of indicators:

1. ***Development indexes of territorial units (regions).*** 13 indicators were evaluated in the regions (GDP, industrial output, agricultural output, construction, retail trade turnover, services (all per capita), unemployment rate, average monthly nominal salary, average nominal consumer spending, poverty rate, number of medical personnel per 10,000 population, teachers per 10,000 population, atmospheric emissions per 1 square meter). For those indicators, each of the 10 regions of the RA was evaluated on a scale of 1-10 points, according to the occupied position, the region in the most favorable condition was evaluated 10, and the region in the most unfavorable condition was evaluated 1. As a result, the classification of the development of the regions was made with the sum of the marks, with which comparisons will be made in the article. The method gives equal weights to the observed indicators to avoid weighting errors. International experience shows that models with equal weights can also be effective: For example, the Human Development Index (HDI) also gives equal weights to

all indicators included in the index (UNDP, n.d.). It should also be noted that the series were normalized to neutralize the problems caused by having equal weights. Normalization is based on classification, as a result of which the territorial unit's score from the indicator is not equal to the indicator itself, but to the score equivalent to the position occupied by that indicator. In other words, a modified version of the Simple Additive Weighting Method was used for the calculations (Arsyah, Jalinus, Syahril, Ambiyar, Arsyah and Pratiwi, 2021).

2. **Total budget revenues per capita.** The index was calculated for the regions. Total budget revenues at the level of the region include the sum of the actual revenues of the budgets of all municipalities in the region.
3. **Own budget revenues per capita.** The index was calculated according to the same logic as the general budget revenues, only the municipalities' budget revenues were included in the calculation.
4. **Budgetary revenues from the state budget per capita.** The index was calculated according to the same logic as the general budget revenues, only the budget revenues of the municipalities received from the state budget were included in the calculation.

Observations were made for the years 2012-2022. To increase the effectiveness of the analysis, dynamic, structural, tabular, and graphical observations were made in the article. The sources of data were the publications of the RA Statistical Committee and the RA Ministry of Territorial Administration and Infrastructures. Calculations were performed by the authors.

ANALYSIS. To assess the financial potential of municipalities at the regional level, we will consider the actual own income per capita (Chart 1).

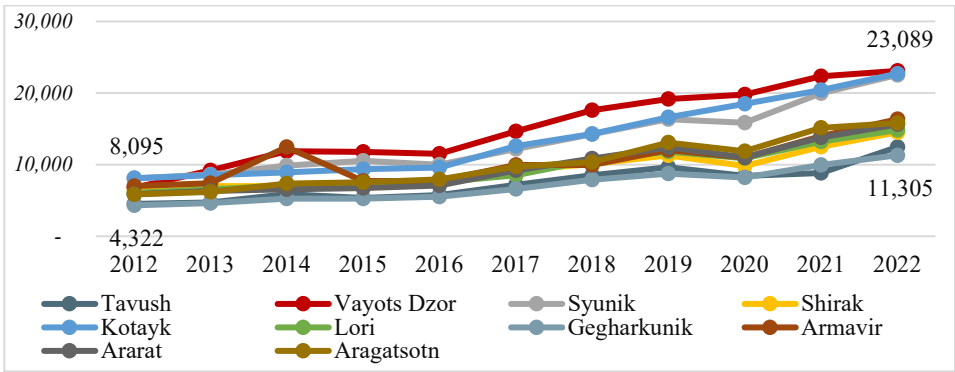


Chart 1. *Municipalities' own budget revenues per capita at the regional level, 2012-2022, AMD (The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, n.d.)*

In 2012-2022, own budget revenues per capita changed quite dynamically. Both average and regional indicators showed clear growth trends during the specified period. As a result, the average index increased cumulatively by 169%, and in the case of regions, the growth rate varied between 133-242%.

Naturally, as a result of such a differentiated growth rate, the regions' budget revenues per capita have become more differentiated over the years. This is also evident by looking at Chart 1 when the inter-curve distances between regions have increased sufficiently. This situation creates a basis for the assumption that the financial potential of municipalities in the regions is currently more differentiated than it was at least 10 years ago. This means that the need for central government bodies to create an effective relationship between state and municipal budgets is currently greater, as the potential asymmetry only increases. The fact, that the ratio of the maximum and minimum indicators of 2012 was 1.87 and the same ratio was 2.04 in 2022, is also an indicator of the increase of the mentioned disparities. In other words, we have a situation where there is a growing disparity between regions in terms of generating their income at the municipality level.

In this case, an important question arises: Is lower financial potential a characteristic of regions with the lowest level of development? We will compare the financial potential and development levels of regions according to quantile groups.

Examining the quantile groups presented in Chart 1, it becomes clear that the regions with the lowest level of development are characterized by low per capita budget incomes. This is evidenced by the fact that the average number of overlaps of quantile groups of these two indicators in 2012-2020 is 4, that is, in the case of 4 out of 10 regions, the quantile group is the same for both indicators. Such a position is further substantiated when the average number of quantile group overlaps or shifts of just one degree is 7. This implies that in the case of 7 out of 10 regions, on average, the quantile group of the two observed indicators either coincided or varied by only one degree. Moreover, in 2020, a similar situation occurred in all regions, when the quantile groups of the two indicators were the same or deviated by only 1 degree. Such a situation gives grounds for asserting that regions with a high level of development are characterized by high budget incomes per capita, and vice versa.

The strong positive relationship between development levels and own budget revenues is also supported by the correlation coefficient calculations (Chart 2).

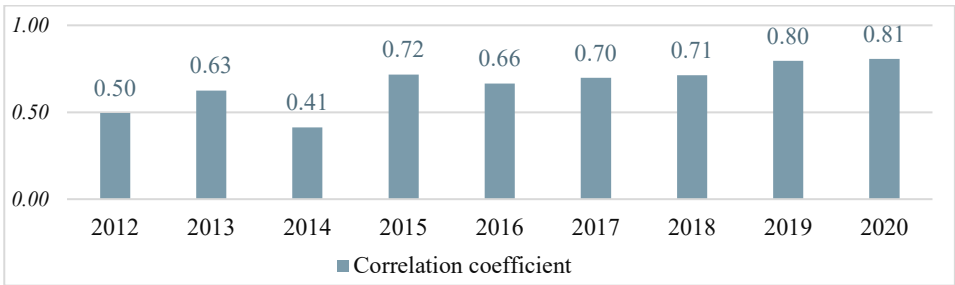


Chart 2. *Correlation coefficients of budget own revenues and development indices, 2012-2020*

Table 1

Comparisons of the RA regions according to the level of development and budget own revenue per capita, 2012-2020
(The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, Publications, n.d.;
The RA Statistical Committee, Regional Statistics, n.d.)

1 - Development index	2-Budget own revenues of municipalities per capita, AMD								QL. 1		QL. 2		QL. 3		QL. 4		QL. 5	
	2012-1	2012-2	2013-1	2013-2	2014-1	2014-2	2015-1	2015-2	2016-1	2016-2	2017-1	2017-2	2018-1	2018-2	2019-1	2019-2	2020-1	2020-2
Syunik	102	8092	103	8624	100	9857	95	10514	95	10017	92	12180	100	14243	99	16343	103	15830
Aragatsotn	88	5841	84	6192	87	7349	88	7530	91	7929	81	9733	80	10351	69	13061	74	11887
Vayots Dzor	81	6761	80	9183	87	11890	90	11767	92	11525	100	14650	90	17612	88	19145	88	19786
Ararat	72	5873	78	6347	75	6571	72	6729	78	7083	84	9177	86	10832	78	12412	76	11011
Shirak	68	6237	59	6987	60	7006	58	7519	56	7257	49	6614	60	10088	63	11309	57	9814
Kotayk	66	8095	72	8534	69	8912	65	9370	66	9581	62	12579	66	14302	73	16614	83	18500
Armavir	65	7011	66	7400	60	12448	62	7711	53	7699	64	9935	68	9929	78	12045	72	10983
Tavush	64	4518	58	4735	54	5894	57	5348	58	5770	64	7183	53	8504	62	9637	57	8408
Gegharkunik	56	4322	53	4620	54	5237	60	5244	60	5504	55	9189	46	7884	41	8751	41	8215
Lori	53	6060	62	6549	69	7104	68	7385	66	7543	64	8523	66	10622	64	11839	64	10878

As it can be seen, the correlation coefficient is high enough, moreover, it even reached 0.81 for 2020, which proves that the levels of development of the RA regions and budget revenues have a relatively high degree of positive dependence. In this case, it is obvious that the relationship between the municipal and state budgets should be built in such a way that not only equality is recorded, but also opportunities are created that will contribute to the progressive development of regions with a low level of development.

Speaking about the financial potential and own incomes, it is now necessary to refer to the question of the state budget financing for the RA municipalities. For this, we will examine the actual financial resources transferred to the RA municipalities in the form of dotations and subventions at the regional level (Chart 3).

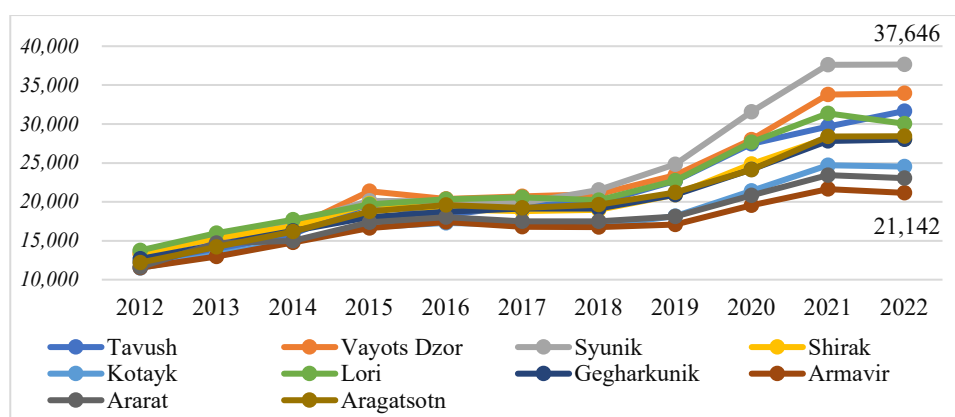


Chart 3. *Per capita budget revenues of municipalities at the regional level, received from the state budget, 2012-2022, AMD (The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, Publications, n.d.)*

Looking at Chart 3, it becomes obvious that per capita incomes from the state budget are much less differentiated than own incomes. That circumstance is justified by such an indicator as the ratio of the maximum and minimum indicators: In 2022, that ratio was 1.78, compared to 2.04 for own incomes. The graphic observation of Charts 1 and 3 is also a substantiating phenomenon, according to which the amplitude of the spread of indicators is much smaller in the case of revenues from the state budget. However, with the same observation, it also becomes clear that this deviation, however, has only increased in the last 10 years, because compared to the 1.78 coefficient of the maximum and minimum indicators of 2022, only 1.20 coefficient was recorded in 2012.

However, to say that the least deviation is an effective situation is not very acceptable, because the funding received from the state budget should be aimed at alleviating the inequalities of own incomes, and in that case, in other equal conditions, the decreased differentiation is not a positive phenomenon.

Table 2

Comparisons of the RA regions according to the level of development and per capita budgetary revenues from the state budget, 2012-2020.

*(The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, Publications, n.d.;
The RA Statistical Committee, Regional Statistics, n.d.)*

1 - Development index		2-Per capita budget revenues of municipalities in the form of dotations and subventions received from the state budget, AMD								QL. 1		QL. 2		QL. 3		QL. 4		QL. 5	
	2012-1	2013-2	2013-1	2014-2	2014-1	2015-2	2015-1	2016-2	2016-1	2017-2	2017-1	2018-2	2018-1	2019-2	2019-1	2020-2	2020-1	2021-2	
Syunik	102	15803	103	17218	100	20133	95	20026	95	19854	92	21514	100	24817	99	31573	103	37612	
Aragatsotn	88	14189	84	16184	87	18786	88	19606	91	19219	81	19627	80	21179	69	24127	74	28385	
Vayots Dzor	81	15343	80	16650	87	21366	90	20389	92	20705	100	20985	90	23416	88	27994	88	33782	
Ararat	72	14696	78	14991	75	17357	72	18012	78	17488	84	17503	86	18125	78	20834	76	23433	
Shirak	68	15374	59	16827	60	19756	58	18996	56	18805	49	18960	60	20895	63	24851	57	28205	
Kotayk	66	13230	72	14935	69	16740	65	17300	66	17065	62	16904	66	18164	73	21417	83	24702	
Armavir	65	12949	66	14799	60	16610	62	17391	53	16792	64	16745	68	17094	78	19566	72	21635	
Tavush	64	13847	58	15866	54	19755	57	18263	58	19557	64	19861	53	22684	62	27449	57	29660	
Gegharkunik	56	14500	53	16257	54	18039	60	18717	60	19134	55	19127	46	20907	41	24171	41	27826	
Lori	53	15985	62	17682	69	19656	68	20334	66	20579	64	20212	66	22703	64	27675	64	31371	

In this case, there is an objective need to study how the amount of funding allocated from the state budget to the municipal budgets is related to the level of socioeconomic development of the region. Observations will be made by quantile groups. A given year's level of development will be compared to the following year's funding to understand how much funding is based on the previous year's level of development.

Examining the data presented in Chart 2, it becomes clear that in practice the process of financing municipal budgets from the state budget is not entirely based on socioeconomic development at the regional level. It is assumed that in order to ensure balanced territorial development, financing from the state budget should be based on the following principle: the highest level of financing volumes in territorial units with the lowest level of development, and vice versa. However, the actual funding volumes are not always based on this principle, in particular, each year, on average, 4 regions were provided with funding completely contrary to this principle, i.e., in 4 cases, on average, the regions in the 1st and 2nd quantiles of the development were also financed in the 1st and 2nd quantiles, as well as the regions in the 4th and 5th quantiles of the development were also financed in the 4th and 5th quantiles (Chart 4).

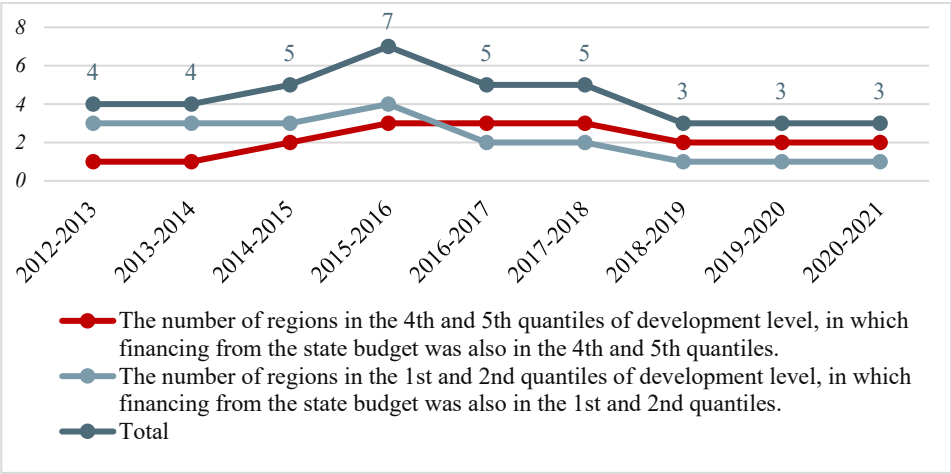


Chart 4. Territorial development level and financing of municipal budgets from the state budget

The non-correlation of the development levels and the financing provided by the state budget to the municipal budgets is also proved by the fact that in no year the correlation coefficient between the levels of development and the volume of financing received from the state budget was negative, which should have been recorded under other equal conditions. Moreover, in the observed 9 years, the correlation coefficient exceeded 0.5 only once, which means that the financing of local budgets from the state budget does not depend on the level of development of regions (Chart 5).

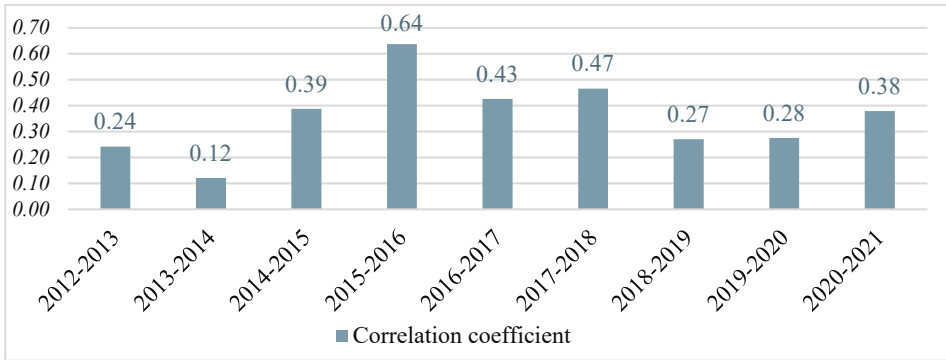


Chart 5. *Correlation coefficients of budget revenues from the state budget and development indices, 2012-2021*

Discussing own incomes, incomes from the state budget and development levels of territorial units, it is necessary to understand how the total financial means of municipalities are associated with their level of development. For this purpose, we will also study the total budgetary incomes of municipalities per capita at the regional level and compare them with the level of territorial development.

In 2012-2022, the total budgetary incomes of municipalities in all regions of the RA, calculated per capita, have continuously increased. The indicator increased 3 times on average, but this increase varied between 2-4 times, depending on the region. This implies a disparity of total budgetary incomes per capita in the RA regions. In terms of total budget revenues per capita in 2012-2022, the continuous differentiation is also proved by graphical observation: The fluctuation range of the indicator has continuously increased (Chart 6).

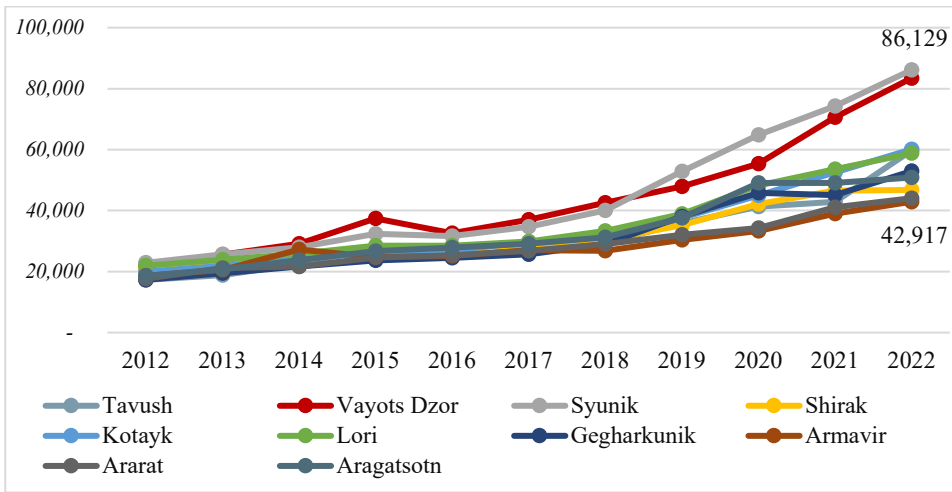


Chart 6. *Total budget revenues per capita of municipalities at the regional level, 2012-2022, AMD (The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, Publications, n.d.)*

Table 3

Comparatives of the RA regions according to the level of development and total budget revenues per capita, 2012-2020

(The RA Ministry of Territorial Administration and Infrastructures, n.d.; The RA Statistical Committee, Publications, n.d.;

The RA Statistical Committee, Regional Statistics, n.d.)

1 - Development index	2 - Total budgetary revenues of municipalities per capita, AMD								QL. 1		QL. 2		QL. 3		QL. 4		QL. 5	
	2012-1	2013-2	2013-1	2014-2	2014-1	2015-2	2015-1	2016-2	2016-1	2017-2	2017-1	2018-2	2018-1	2019-2	2019-1	2020-2	2020-1	2021-2
Syunik	102	25649	103	28004	100	32388	95	31648	95	34701	92	40032	100	52861	99	64834	103	74317
Aragatsotn	88	20750	84	23742	87	26715	88	27921	91	29176	81	31212	80	37663	69	49040	74	49088
Vayots Dzor	81	25538	80	29156	87	37425	90	32648	92	37024	100	42563	90	47892	88	55423	88	70631
Ararat	72	21132	78	21666	75	24589	72	25348	78	26795	84	29026	86	32057	78	34225	76	41129
Shirak	68	22901	59	24703	60	27888	58	26688	56	28499	49	30403	60	35246	63	42170	57	46605
Kotayk	66	21836	72	23943	69	26246	65	26915	66	29721	62	32212	66	37598	73	45017	83	52502
Armavir	65	20474	66	27247	60	24729	62	25172	53	26999	64	26863	68	30426	78	33313	72	38952
Tavush	64	18824	58	22498	54	27821	57	25942	58	27931	64	29537	53	35800	62	41326	57	42844
Gegharkunik	56	19460	53	21699	54	23632	60	24562	60	25626	55	29075	46	38034	41	45843	41	45099
Lori	53	23870	62	25838	69	28513	68	28501	66	29911	64	33282	66	38920	64	48221	64	53582

It is also necessary to carry out a comparison of territorial development indicators and total budget revenues per capita (Table 3). A given year's level of development will be compared to the following year's revenue to understand how much the revenue volume is based on the previous year's level of development.

The data presented in Table 3 shows that the relationship between the state and municipal budgets has nothing to do with giving proportionality to territorial development. Such a conclusion can be made based on the following data: On average, 2 regions with a higher than average level of socioeconomic development have higher than average per capita budget revenues, and on average 5 regions with a lower than average level of socioeconomic development have lower than average per capita budget revenues (Chart 7).

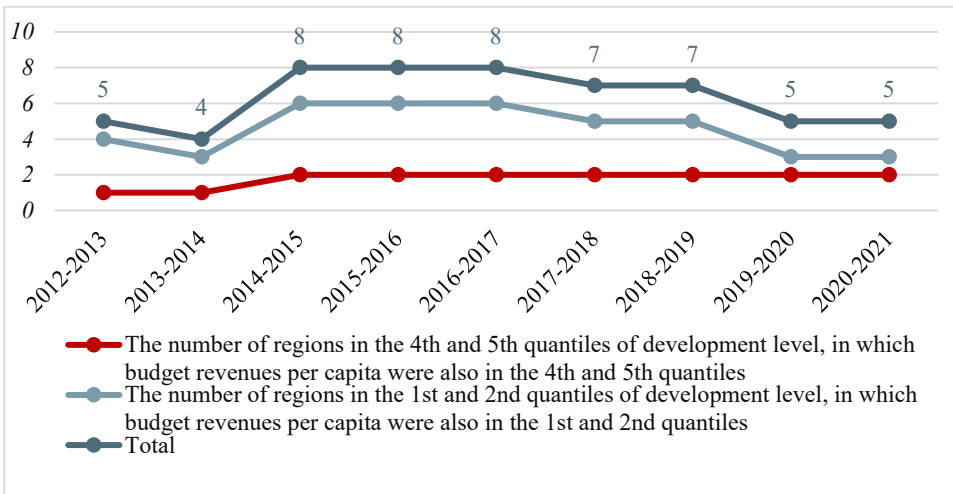


Chart 7. Territorial development level and total revenues of municipal budgets

A direct comparative and strong relationship between budget funds and the level of development cannot be derived from the goal of ensuring balanced territorial development. That strong and positive relationship is also justified by the rather high and positive correlation coefficients (average: 0.62) of these two indicators (Chart 8).

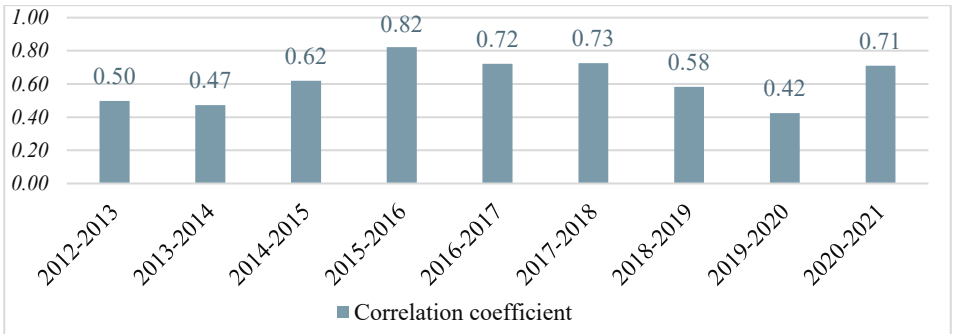


Chart 8. Correlation coefficients of budget revenues and development indices, 2012-2021

CONCLUSIONS. As a result, it turns out that:

1. In the Republic of Armenia, the possible relationship between the state and municipal budgets is not used to overcome the disparities of territorial development in the country.
2. The currently formed situation can lead to the deepening of the existing disparities between the levels of socioeconomic development of the regions of the Republic of Armenia, because regions with a higher level of development are characterized by higher budget revenues, and vice versa.
3. The central government bodies of the Republic of Armenia do not act as a regulator and carry out such financing of the municipal budgets of the regions, which does not derive from the goals of the territorial development policy, that is, to ensure balanced territorial development.
4. The problem is mainly within the framework of the legal regulations in force in the Republic of Armenia, which define the financing mechanisms of the municipal budgets from the state budget of the Republic of Armenia.

In this context, it is necessary to record that these mechanisms should be given a new character. Through them it is necessary to solve not only the narrow problems of the specific municipality, but also it is necessary to give symmetry to the territorial development of the Republic of Armenia. This does not imply that the funds transferred from the state budget to the municipality budgets should be allocated only on the basis of the level of development, but it implies that, in addition to the existing criteria, these relationships should also be based on the level of development.

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