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**Prof. Dr. As. Zlatarov University
National University
of Life and Environmental Sciences of Ukraine**



**IV International Scientific and Practical
Conference**

**Ukraine, Bulgaria, EU:
Economic, Technical
and Social
Development Trends**

**27 June - 3 July 2020
Burgas, Bulgaria**

**Prof. Dr. As. Zlatarov University
National University of Life and Environmental
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FISCAL POLICY AND ITS MECHANISM

Welcome to the world of fiscal policy! So with a light hand of J. M. Keynes it is customary to name an area of the economy that is directly related to the interaction of state bodies and all other business entities. This interaction is achieved through a system of government orders, taxation and transfer payments.

Since the implementation of public spending means the use of state budget funds and taxes are the main source of replenishment, fiscal policy comes down to manipulating the state budget.

Fiscal policy is a very powerful weapon. Some economists argue that this like an atomic bomb, is too powerful a weapon to allow individuals and governments to play with it; so it would be better if fiscal policy were never applied. Nevertheless, it is absolutely certain that just as no nation will sit idly by allowing the plague to mow the population, in the same way fiscal policy always comes into play in every country as soon as a depression begins to unfold. There is no other choice than to try to direct fiscal policy in a healthy rather than pernicious direction.

Any government always pursues some fiscal policy regardless of whether it is aware of it or not. The real question is whether this policy will be constructive or whether it will be unconscious and inconsistent.

The topic of fiscal policy today is very relevant, since the economy of the republic isn't going through the best of days and the fate of every person living in our country and the fate of the whole country depends on how the government

will implement the fiscal policy. As the surgeon's scalpel heals, cutting off the unnecessary the government needs to move in such a way as to cut off unnecessary government spending to minimize taxation of business entities, thereby creating the most favorable conditions for business development but at the same time not to deprive transfer payments of those who they really need.

One of the main tools of macroeconomic regulation is fiscal policy. Under fiscal policy understand the totality of measures taken by government bodies to change public spending and taxation. Its main tasks are: smoothing the fluctuations of the economic cycle, ensuring sustainable economic growth, achieving a high level of employment, reducing inflation.

Fiscal policy, depending on the mechanisms of its regulation for changing the economic situation is divided into discretionary and automatic fiscal policies (policies of built-in stabilizers).

Discretionary policy is understood as the deliberate manipulation of government spending and taxes. It is also called active fiscal policy. It can be carried out using both direct and indirect tools. The first include a change in government procurement of goods and services, transfer payments. The second includes changes in taxation (tax rates, tax benefits, tax base) accelerated depreciation policy.

Consider the mechanism of discretionary fiscal policy using the Keynesian model of "income - expenses" and assuming that: 1) government spending doesn't affect either consumption or investment; 2) net export is zero; 3) the price level is constant; 4) initially in the economy there are no taxes; 5) fiscal policy has an impact on total costs (aggregate demand) but not on aggregate supply.

Given these assumptions we analyze the impact of changes in government spending on the volume of national production (output), income.

In practice the level of government spending and tax revenues can change even if the government doesn't take appropriate decisions. This is due to the existence of built-in stability which defines an automatic (passive, non-discretionary) fiscal policy. Built-in stability is based on mechanisms that operate in self-regulation mode and automatically respond to changes in the state of the economy. They are called built-in (automatic) stabilizers. These include:

1. Changes in tax revenue. The amount of taxes depends on the income of the population and enterprises. In a period of decline in production, revenues will begin to decrease which will automatically reduce tax revenues to the treasury. Consequently the income remaining in the population and enterprises will increase. This will to some extent slow down the decline in aggregate demand which will positively affect the development of the economy. The progressiveness of the tax system has the same effect. With a decrease in the volume of national production, incomes decrease but at the same time tax rates decrease which is accompanied by a decrease in both the absolute amount of tax

revenues to the treasury and their share in the company's income. As a result, the fall in aggregate demand will be milder.

2. Unemployment benefit systems and social benefits. They also have automatic counter-cyclical effects. Thus an increase in the level of employment leads to an increase in taxes which finance unemployment benefits. With a decline in production the number of unemployed increases which reduces aggregate demand. However at the same time the amount of unemployment benefits is also growing. This supports consumption, slows the decline in demand and therefore counteracts the growing crisis. In the same automatic mode the systems of income indexation and social payments function. There are other forms of built-in stabilizers: farmer assistance programs, corporate savings, personal savings, etc.

Built-in stabilizers mitigate changes in aggregate demand and thereby help stabilize national output. It is thanks to their action that the development of the economic cycle has changed: the decline in production has become less deep and shorter. Previously this wasn't possible since tax rates were lower and unemployment benefits and social benefits were negligible.

The main advantage of a non-discretionary fiscal policy is that its instruments (built-in stabilizers) turn on immediately at the slightest change in economic conditions, there is practically no time lag.

The disadvantage of automatic fiscal policy is that it only helps smooth out cyclical fluctuations but cannot eliminate them. It should be noted that the higher the tax rate, the higher the transfer payments, the more effective the non-discretionary policy.

Depending on the purpose, a stimulating or restraining fiscal policy is pursued. In periods of decline in production it is necessary to increase government spending, reduce taxes or do both, pursue a stimulating (expansionist) policy. In the short term it softens the business cycle. In the long term tax cuts can lead to economic growth. This was the case in the 1980s in developed countries where tax reforms, as a result of which corporate income tax and income tax rates were reduced, helped boost the economy.

In order to reduce inflation, they are implementing a restraining (restrictionist) fiscal policy. It consists in cutting government spending, increasing taxes or in a combination of both. In the short term restraint policies reduce aggregate demand and thereby help reduce demand inflation. In the long term it can lead to a decline in production and an increase in unemployment.

A change in the full employment budget shows how the current fiscal policy affects the change in aggregate demand. An increase in the deficit or a reduction in the surplus of the full-employment budget indicates a stimulating fiscal policy aimed at expanding aggregate demand. On the contrary, a reduction in the deficit or an increase in the surplus of the full employment budget is the re-

sult of the implementation of a restraining fiscal policy the aim of which is to reduce aggregate demand.

According to the Keynesian approach the use of taxes as an important tool of fiscal policy can stimulate business and investment activity, since tax cuts leave at the disposal of entrepreneurs a much larger portion of money than the amount of tax cuts.

However, this provision applies only to proportionate taxes. They play the role of automatic stabilizers of the economy.

Fiscal policy is one of the main tools of macroeconomic regulation.

1. Fiscal policy, depending on the mechanisms of its regulation for changing the economic situation, is divided into discretionary and automatic fiscal policies (policies of built-in stabilizers).

2. The most significant fiscal instruments are taxes and government procurement.

3. One of the important tools to influence the rate of economic growth and consequently, the unemployment rate is the financial including tax system.

4. The tax system of any country is effective if it is formed on common methodological approaches that take into account the solvency of the population, tax benefits for the strategic goals of the economy an even distribution of taxes among business entities, the optimal tax burden, etc.

5. Due to the multiplier effect each unit of the reduction of the proportional tax accounts for much more units of GDP growth.

6. Discretionary and non-discretionary fiscal policies are applied in combination, depending on the current dynamics of GDP⁷. According to the Keynesian concept of fiscal policy the budget deficit as a rule, increases during a recession and decreases during periods of recovery and economic recovery.

8. According to the classical concept, fiscal policy is considered only as an instrument of financial support for the government to fulfill its functions, but not as a stabilization policy.

9. The state budget is an estimate of state revenues and expenditures for a certain period, most often for a year, drawn up with an indication of the sources of state revenues and areas of expenditure.

10. There are three ways to finance the budget deficit:

11. Changes in the fiscal sphere and fiscal policy play a key role in the economic development of the country and the implementation of an effective economic policy.

A system of public procurement is being developed on a competitive basis. A generally accepted classification of budget revenues and expenditures (including economic), as well as sources of internal and external financing of the budget deficit and types of public debt, has been introduced.

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FINANCIAL DERIVATIVES MARKETS DEVELOPMENT IN THE GLOBALIZATION PROCESS

In modern situation, globalization has a strong influence on the formation of world financial derivatives markets. Global instability and numerous financial risks increase the need to use various tools and mechanisms of risk management.

The long history of the world stock market formation has helped to transform the exchanges from wholesale markets into financial centers of pricing. A clear system of regulation helps to ensure transparent and equal conditions for the all participants in derivatives trading. This creates a high level of confidence and increases the liquidity of derivatives trading.

Most developed countries effectively use financial derivatives to manage price risks. Today, exchange-traded derivatives markets are very popular for investment strategies and hedging price risks. The main goal of these instruments is opportunity to buy or sell financial assets in future periods. In this case, wide period can makes it possible to use financial derivatives not only for speculative purposes, but also as risk management tools.

Globalization contributes to the integration of global commodity and financial markets. This provided qualitative and quantitative changes in the derivatives trading.

Globalization processes have strengthened the competitive conditions of the exchanges and increased their quality performance. The competitive conditions of the derivatives exchanges led to the beginning of consolidation and mergers. This ensured a new level of exchange performance at the intercontinental or global level (fig.1).

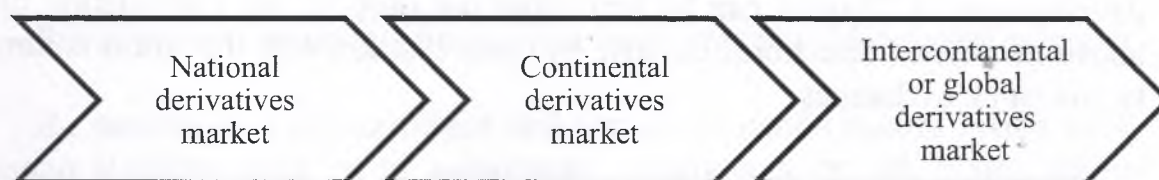


Figure 1. Effect of globalization on transformation of derivatives market