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SUSTAINABLE FISCAL POLICY

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Abstract. A sustainable fiscal sector and policy as the main regulating element of any economic system, has become an important element of macroeconomic equilibrium. The article is devoted to the analysis of the problems of fiscal rules from macroeconomic stability point of view.

Keywords: Fiscal policy, fiscal rule, consolidation, budget deficit.

DAYANIQLI FİSKAL SİYASƏT

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Xülasə. Davamlı fiskal sektor və siyasət istənilən iqtisadi sistemin əsas tənzimləyici elementi kimi makroiqtisadi tarazlığın mühüm elementinə çevrilmişdir. Məqalə makroiqtisadi sabitlik baxımından fiskal qaydalar problemlərinin təhlilinə həsr edilmişdir.
Açar sözlər: Fiskal siyasət, fiskal qayda, konsolidasiya, büdcə kəsiri.

УСТОЙЧИВАЯ ФИСКАЛЬНАЯ ПОЛИТИКА

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Резюме. Устойчивый фискальный сектор и политика, как главный регулирующий элемент любой экономической системы, стали важным элементом макроэкономического равновесия. Статья посвящена анализу проблем фискальных правил с точки зрения макроэкономической стабильности.
Ключевые слова: Фискальная политика, фискальное правило, консолидация, бюджетный дефицит.

1. Introduction

Fiscal discipline is defined as balance sheet and debt discipline in the vast majority (about 60%) of the countries where it is applied, which results from governments' greater preference for fiscal stability-related discipline. Fiscal rules are classified by type as expenditure, revenue, balance and debt rules.

Fiscal regulations differ from each other in terms of design and implementation. Anglo-Saxon countries (Australia, Canada, New Zealand, England) mainly attach great importance to transparency, continental Europe and some developing countries (Argentina, Brazil, Colombia, Peru, India) are characterized by setting digital targets, with a federal political system and countries are distinguished by the autonomous status of states or other federal units.

By the decree of the President of the Republic of Azerbaijan dated August 24, 2018, the procedure for the preparation of the medium-term expenditure framework in the country was established, which is considered as an important step for the protection of the country's macroeconomic instability under the effects of a complex external environment, and for ensuring the stability of financial stability.

Different fiscal rules have different effects on target indicators such as debt sustainability, macroeconomic stabilization and government share in the economy through automatic stabilizers and the effectiveness of discrete fiscal policy. This effect can be strongly positive, weakly positive and neutral.

The rules are aimed at correcting distortion initiatives in the formation of fiscal policy. Such distortions involve two unavoidable problems; i) lack of vision of politicians - propensity to spend due to the desire for re-election, ii) "public pool problem" - high group interests over budget funds.

At the same time, parallel to the above-mentioned advantages, fiscal regulations are recognized to have a number of weaknesses:

First, without the necessary political commitment to the rules and established preconditions, the fiscal rule cannot be sustainable and ultimately the credibility of the fiscal policy will be further reduced.

Second, regulations, especially deficit and debt regulations, can cause procyclicality. Such a situation is possible due to insufficient savings during the expansion phase of the cycle and excessive spending restrictions during the recession.

Third, regulations can lead to a decline in the quality of fiscal policy. Thus, during fiscal consolidation, capital expenditures are subject to significant reductions, which may have a negative impact on the country's long-term development.

Fourth, regulations can encourage the development of "creative and dual" accounting, as Greece is a typical example.

2. Fiscal rules applicable in countries [1]

<u>Norway</u>

The non-oil cyclical adjusted budget deficit cannot exceed the income from the management of the State Pension Fund.

<u>Germany</u>

The new rule covers the years 2009-2020. The rule stipulates that the cyclical budget deficit should be 0.35% of GDP. The Constitutional Court has the right to dismiss a government that does not comply with this rule , and at the same time the establishment of a Stabilization Council outside the government (the purpose of monitoring and early warning) is envisaged.

<u>Turkey</u>

The current year's budget deficit is calculated using a formula that depends on the difference between the previous year and the difference between actual economic growth and medium-term economic growth. The rule envisages less borrowing if the budget deficit is higher than in previous years or the rate of economic growth is lower than the target.

<u>Denmark</u>

The rule envisages a cyclically adjusted budget without deficit at least in 2015. According to the rule, direct and indirect taxes cannot be increased.

<u>Chile</u>

The cyclically adjusted budget balance was set at 1% of GDP for 2001-2007, and 0.5% from 2008. An independent Council of 15 experts submits forecasts for copper, molybdenum prices (the main export earnings) and aggregate output deficit to the government, on the basis of which the medium-term budget envelope is developed.

<u>Bulgaria</u>

Budget expenditures cannot exceed 40% of GDP.

<u>Kenya</u>

The rule includes that the ratio of budget revenues to GDP should not exceed 22%, and the ratio of public debt to GDP should not exceed 40%.

<u>Botswana</u>

Budget expenditures cannot exceed 40% of GDP.

Currently, two opposite opinions are being heard in the debates about the budget policy of the IEP. According to one side, as long as unemployment remains at the current level, it is not rational to tighten the budget policy. On the other hand, fiscal consolidation is inevitable at a time when public debt is high.

It is risky to reduce the budget deficit to a large extent when the market conditions are not suitable. However, fiscal adjustment cannot be postponed for two reasons. First, the market may lose confidence that the government will honor its debt obligations. Second, a large budget deficit increases public debt, which in turn has a negative impact on economic growth. Thus, a 10% increase in public debt reduces the possible GDP growth in GDP by 0.15%. It would be ideal for countries to refrain from fiscal consolidation now and do so in the future. However, the government should introduce some strict policies to begin with to ensure that its future plans are implemented accurately.

It is expected that the ratio of public debt to GDP will increase. There are expectations that a low budget deficit and high economic growth will lead to a decrease in public debt in the Republic of Uzbekistan.

The tendency to purchase government securities by central banks in the Central Bank of Ukraine is decreasing. It should be recalled that during the crisis years, 85% of the UK budget deficit was financed by the Bank of England.

The recovery of economic growth has resulted in limited direct assistance to the financial sector in other economies except Ireland.

Currently, the overall funding needs of the IEP are high and are expected to continue to grow. Debt maturities are expected to increase the average financing need to 27% of GDP in the coming years. The need for financing of IEOÖ and AGÖ is less than that of EEO. LDCs continue to benefit from improved fiscal management prior to the crisis. A strong policy framework in the GCC enables domestic financing of large deficits without harming macroeconomic stability.

Since the beginning of the crisis, the decrease in investors' willingness to take risks has resulted in the reduction of debt maturities by governments. However, the stabilization of the market and the increase in investor confidence led governments to extend maturities again, which reduced the weight of short-term debt in the total share. It is expected that the weight of short-term debts in the member countries of the Organization for Economic Cooperation and Development will be around 60%.

The market's reaction to fiscal changes is reflected in the interest rates and yields of government short-term debt securities. This reaction is mostly based on the degree of riskiness of the countries. The yield of government debt securities is decreasing in the IEE. This is related to low inflation expectations, increased investor interest and high economic growth expectations. The increase in investors' demand for government debt securities is closely related to the incomplete restoration of stability in the banking sector of some small CEEs. So, in this case, investors perceive government securities as a less risky asset and show interest in them to increase the quality of their portfolios.

Fiscal consolidation plans of most G20 countries mainly cover the medium term, but in some countries (USA and Great Britain) this period covers a longer period. Although market pressures differ, overall the scale and pace of announced consolidation maintain a balance between reducing the budget deficit and supporting economic growth.

Most of the plans involve cost-oriented consolidation, while the rest involve mixed or revenue-oriented consolidation. Past experience shows that expenditure-oriented fiscal consolidation is less harmful to economic growth than when accompanied by monetary stimulus. But it is difficult to succeed with just consolidation. Therefore, by carrying out fiscal management and structural reforms in parallel with consolidation, the goals can be achieved without adversely affecting economic growth.

Planned composition of fiscal consolidation

<u>Countries with large (over 10% of GDP) deficits</u>

- Ireland, Japan, Spain, United Kingdom (mostly cost oriented)
- USA, Greece, India (mixed)

<u>Countries with medium (between 5-10% of GDP) deficit</u>

- Portugal, Canada, France, Italy, Latvia, Lithuania, South Africa, Turkey (mainly cost oriented)
- Russia (mixed)

Low (below 5% of GDP) deficit countries

- Australia, Germany, Korea, Saudi Arabia (mainly cost oriented)
- Mexico (mixed)
- China (mostly revenue oriented)

Cost-wise consolidation has a share of at least 60% in total consolidation. 40% of the mixed budget policy is expenditure-oriented and 60% is income-oriented policy.

Cost reduction mainly means reduction of salaries, volume of public services and social transfers. The increase of budget revenues is based on the increase of direct taxes. Personal income tax, corporate income tax and social security contributions account for about 50% of total revenue consolidation. The increase of VAT and excise tax makes up 1/3 of the applied methods of revenue growth. [2]

Structural reforms are of great importance to close the budget deficit in the medium term. Pension reforms have already been implemented in many CEEs, and pension costs are expected to increase by 1% over the next 20 years. However, if these reforms were not carried out, the growth rate of expenses would be 3%. Little has been done to manage health spending in the CEE, which is expected to reach 3.5% of GDP by 2030.

Fiscal and budgetary institutions are being strengthened in many countries. Germany adopted the constitutional structural budget balance rule. Great Britain organized the Office of Budgetary Responsibility and presented the necessary documents to the Parliament for the operation of this office on a permanent basis . However, fiscal and budgetary institutions need to be further strengthened to support the consolidation process. In particular, most G20 countries need to improve the breadth, depth and timing of fiscal accountability, forecasting and risk management.

Although the budget deficit is expected to decrease in the medium term in most countries, the budget policies of the states are not sufficiently developed. Firstly, the methods of consolidation are often not defined precisely and in detail. Second, although reforms in the health sector are envisaged in the short term , extensive reforms in the medium and long term needed to reduce costs in this area have not been announced. Third, very few countries have made long-term commitments regarding the amount of public debt.

Postponement of budget problems depends on three factors. 1. Long-term fiscal orientation (ability to pay in the long-term period); 2. Possible negative shocks (macroeconomic, financial sector and policy shocks) that may arise around the fiscal benchmark; 3. Market sensitivity.

Despite fiscal consolidation initiatives in most CEEs next year, public debt is expected to increase in the medium term. It is noted that the reduction of public debt depends on long-term sustainable fiscal consolidation and the political will of the country's authorities [2]. If governments do not commit to reducing public debt before consolidation, they will be less interested in cutting spending to avoid losing the favor of their constituents after debt stabilization.

Proposals are made on fiscal reforms that serve to strengthen state finances without adversely affecting economic growth. It is noted that although the fiscal results of reforms in the state pension system with three different scenarios are close to each other, their impact on economic growth is significantly different from each other.

The public debt is expected to decrease by 30% during the same period. This method encourages longer working hours with higher income , and in turn leads to lower population savings and increased consumption during working years.

Reducing the amount of the pension encourages savings during the working years so that the population does not experience a sharp drop in income at retirement age. Thus, despite the decrease in consumption in the medium term, the growth of investments will be observed in the long term.

Increasing insurance premium rates has a negative impact on economic growth by reducing aggregate demand.

Above-mentioned scenarios in most countries has the potential to increase real GDP more than other scenarios.

In the wake of the financial crisis, countries are evaluating the adequacy of tax policy towards the financial sector. Some "Big 20 " countries have started levying temporary taxes on the financial sector to cover the damage of the recent crisis. Already, some G20 countries have created financial stability funds to prevent possible future crises (by satisfying the need for financial assistance) or at least to finance possible damage. [3]

In the conditions of Azerbaijan, fiscal stability is mainly related to reducing the budget's dependence on oil and limiting the use of oil revenues. Among the oil-producing countries, Norway applies a similar limit, which is limited to the income from the management of the country's Oil Fund assets. The principle of "perpetual income" implies that the government will keep a stock of oil revenues for the next 25 years and spend only the interest income. Applying such a limit in the economy of Azerbaijan can create conditions for more reliable protection of funds accumulated in the Oil Fund. This will allow achieving fiscal stability in the long term.

Increasing the role of countercyclical macroeconomic stabilization of fiscal policy in the country includes the introduction of rules that adjust budget expenditures according to economic cycles and automatic stabilizers that will increase the effect of the composition of budget expenditures on economic cycles. The rules that correct the budget expenditures according to economic cycles mainly aim for a cyclically cleaned budget balance, and apply the rules that link the level of the budget deficit directly with the rate of economic growth.

Paralelly with rational countercyclical macroeconomic policy the fiscal policy should answer the following questions from starting point.

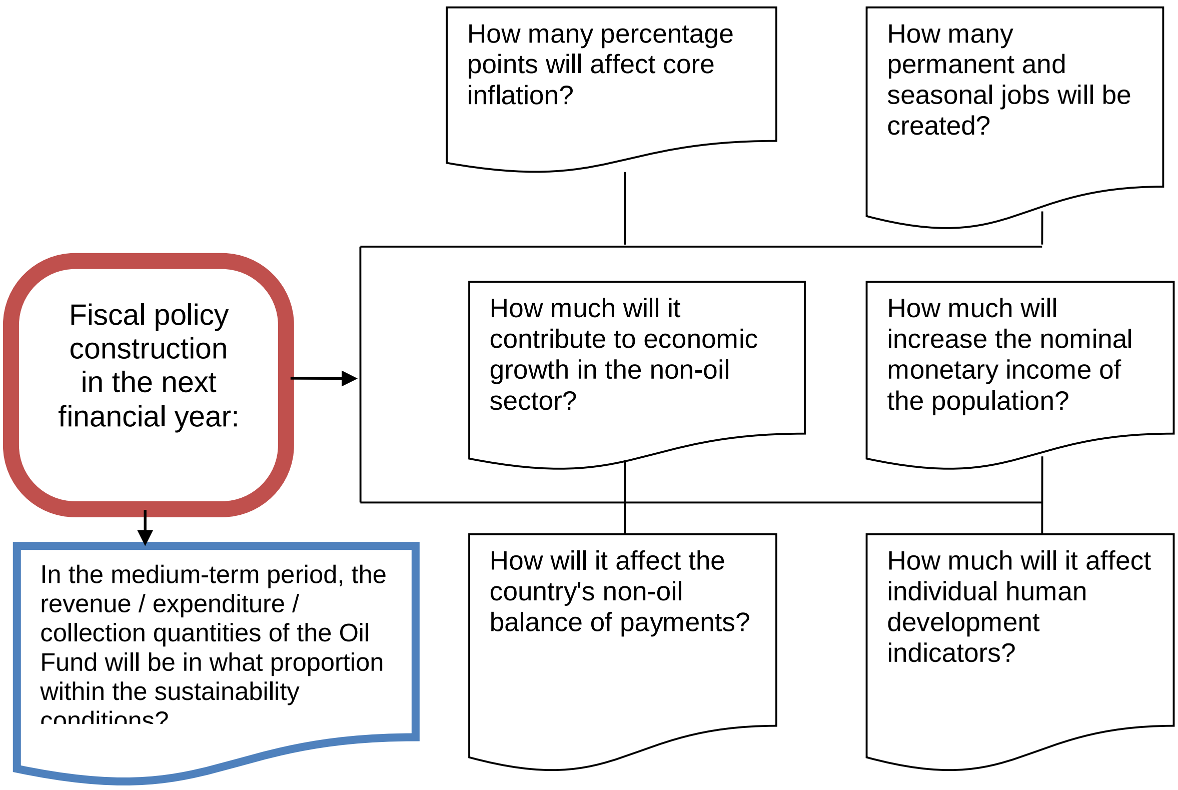

Fig. 1. Constructive questions of fiscal policy

As it is known, lags in the implementation of fiscal policy and its implementation within the limits of political economy somewhat reduce its effectiveness during recessions. In order to eliminate this problem from the point of view of the economy of Azerbaijan, there should be automatic stabilizers within the budget income and expenses.

Strengthening the automatic response of budget revenues to cycles:

- having a progressive tax system;
- the return of part of the taxes paid to low income groups of the population;
- requires the tax exemption of funds directed to investment depending on the cycles.

As automatic stabilizers in budget expenditures, transfers for the population whose income level is below a certain threshold, unemployment benefit system, etc. is related to the implementation of social insurance programs.

The application of various rules in the implementation of fiscal policy in Azerbaijan has the potential to significantly limit its discretion. This may prevent fiscal stimulus programs from being implemented beyond the limits allowed by fiscal rules in the event of severe recessions. [4]

In this regard, any fiscal rule should include exceptions for recessions. However, these exceptions for the country's economy should be explained in detail and it should not be allowed to be used for political purposes.

The analysis shows that attention should be paid to ensuring that budget expenditures are aligned with the country's strategic goals and ensuring efficiency in budget expenditures. In order to ensure this, it is necessary to apply a medium-term spending strategy. This strategy serves to achieve a more effective use of resources by linking the government's policy in the medium term with strategic goals. This implies that budget expenditure planning is based on the "top-down" principle.

A medium-term expenditure strategy requires the budget process to be focused over several years, allowing it to reflect the government's medium-term economic priorities, rather than just one year. The strategy is based on a single document that reflects the country's priorities for the long term. Here, the main goals that the country wants to achieve in the long term, and appropriate strategies to achieve these goals are reflected. In such documents, specific goals for the long-term economic development of the country, improvement of the social conditions of the population and other issues are defined, and a program of measures to achieve these goals is put forward.

In general, the development of the securities market as one of the leading elements of the financial system has taken an important place in the economic and financial policy of the state and has been kept in the center of attention.

Continuous legal and organizational measures are implemented in this area. Necessary normative legal framework and regulatory mechanisms, trade, clearing and settlement systems, financial mediation institutions have been established in the securities market.

A diversified financial sector and, in particular, the existence of a highly efficient securities market are necessary for a developed model of market relations. As the most dynamic element of the financial system, securities, especially the raising of the state securities market to a qualitatively new level, expands the possibilities of regulating the economy, facilitates the attraction of financial resources to the real sector and cross-sectoral investment flows. At the same time, it creates conditions for the efficient operation of the economic system by promoting a system of necessary requirements such as increasing transparency in corporate management and economic activity.

The current stage of the development of the national economy implies further expansion of access to financial services for economic subjects. This requires the continuous development and improvement of capitalization mechanisms that ensure the transformation of savings into direct investments as a cheaper, non-inflationary and long-term source, along with financing sources from the budget and the banking sector. [5] Ensuring the diversification of investment processes, creating opportunities for small and medium-sized economic subjects, as well as the population to direct their savings to the economy, makes the immediate social importance of the stock market even more relevant.

The analyzes show that there is a serious need to expand the offer of highly competitive financial instruments in the state's debt securities market, to apply the experience of financing infrastructure projects with stock market instruments in order to increase the interest of foreign investors in the Azerbaijani securities market, and to create various debt securities and futures contracts trading mechanisms. there is

The existence of a favorable tax environment in the country is important for the efficient functioning of the capital markets, financing from the capital markets of the private sector and the expansion of investment opportunities as a whole . However, at present, the improvement of the conditions of taxation in the securities market in the country based on advanced international practice, including the mechanisms of applying tax benefits to investment income from securities, income from the purchase and sale of securities, have not been fully developed and implemented. Also, there is a need to create favorable fiscal conditions in the country that will encourage the activity of investment funds and the listing of companies on the stock exchange.

The analysis of the circulation of treasury bonds shows that the volume of submitted orders for these financial instruments in each issue significantly exceeds the volume of the issue. This indicates that there is a high market demand for the mentioned financial instruments. As a result, according to the analysis of the actual indicators for all issues, the issued bonds were fully placed. This leads to the conclusion that the government has the ability to mobilize funds from the state's debt securities market in a larger volume than the current scale.

In addition to the mentioned feature, a qualitative analysis of the market in question shows that a small number of investor institutions are behind the potentially high demand. This can also be explained by the lack of supply. It should also be taken into account that the volume of the offer for one issue is on average 5-6 million manats, which is quite small compared to the financial capabilities of commercial banks, which are currently the main investors of government short-term bonds. At the same time, demand far exceeding supply causes bond yields to fall, allowing the government to borrow at a cheaper cost than the domestic market.

Conclusion. The analysis of macroeconomic regulatory frameworks in benchmark countries, including the system of fiscal regulations, shows that this is closely related to the general national economic development model, especially the quality issues of economic growth in the country as its important indicator. That is, the more the framework of fiscal rules defined in the country is aimed at macroeconomic stability, the more the issues of its impact on economic growth should be taken into account. Undoubtedly, the social security of the population, the goals of continuous improvement of the living standards of various population groups in general act as the main determinants of these frameworks.

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