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**ZHU LIHONG**

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**DISSERTATION**

# THE IMPACT OF FISCAL POLICY ON SMALL AND MICRO ENTERPRISES UNDER GLOBAL ECONOMIC CRISIS

Speciality 292 – “International Economic Relations”

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The dissertation contains the results of my own research. The use of ideas, results, and texts of other authors are linked to the corresponding source.

朱丽红 Zhu LIHONG

**Research supervisor:** Roman Zvarych, Doctor of Economics, Professor

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## АНОТАЦІЯ

*Чжу ЛІХУН*. **Вплив фіскальної політики на малі та мікро підприємства в умовах глобальної економічної кризи**. – Кваліфікаційна наукова праця на правах рукопису.

Дисертація на здобуття ступеня доктора філософії за спеціальністю 292 «Міжнародні економічні відносини». – Західноукраїнський національний університет, Тернопіль, 2025.

У дисертації запропоновано нове вирішення важливого науково-прикладного завдання – обґрунтування теоретичних та методичних засад фіскальної політики та концепції її трансформації в умовах глобальної економічної кризи та розробки комплексної моделі фіскальної політики, спрямованої на сприяння розвитку ММП у Китаї.

У цьому дослідженні було проаналізовано макроекономічні засади фіскальної політики, зокрема використання емпіричних методів дослідження дозволило показати еволюцію теорій фіскальної політики. У дослідженні показано роль автоматичних стабілізаторів фіскальної політики у розвинених економіках та в економіках, що розвиваються. У дослідженні доведено, що ефективність фіскального реагування залежить від фіскальних можливостей уряду та економічного контексту, особливо в сценаріях, що характеризуються інфляцією або зовнішнім дефіцитом, де його стимулювання може бути неефективним. В роботі показано, що фіскальна політика суттєво впливає на сукупний попит, розподіл багатства та виробничий потенціал. Зокрема зазначено дихотомію між короткостроковими фіскальними втручаннями, спрямованими на стимулювання попиту під час спадів, та довгостроковими цілями, такими як збільшення національних заощаджень та інвестицій.

В роботі розглянуто середовище, операційну структуру та класифікацію мікро- та малих підприємств (ММП); встановлено, що донорські та розвиваючі організації визнають трансформацію бізнес-середовища життєво важливою для подолання викликів, з якими стикаються ММП. Вищезазначене дозволило встановити пріоритетні сфери реформ, включаючи спрощення реєстрації бізнесу,

покращення податкового адміністрування, доступ до судової системи та механізмів діалогу між державним та приватним секторами. Показано, що політична нестабільність та обмежений інституційний потенціал у країнах, що розвиваються, перешкоджають прогресу реформ.

Також було виділено вплив гендерно-специфічних правових та культурних бар'єрів на ММП, очолюваних жінками. Аналіз теоретичних моделей, що лежать в основі реформи бізнес-середовища для ММП, включає теорію «рівних умов гри», що визначає однакове рівне ставлення до всіх підприємств, «диференційований підхід», що підтримує адаптовані реформи для менших фірм, та теорію формалізації, яка стверджує, що покращення бізнес-середовища може стимулювати неформальні ММП стати формальними.

В процесі дослідження розглянуто ефективність та обмеження механізмів фінансової та фіскальної підтримки, спрямованих на мікро- та малі підприємства. Зокрема виявлено, що індивідуальна фінансова допомога підприємствам не завжди є достатньою, а численні секторальні інформаційні платформи мають неякісну комунікацію, що призводить до затримок в обміні інформацією, що знижує своєчасність та актуальність можливостей фінансування. У дослідженні проаналізовано різні форми державної підтримки, включаючи фінансові субсидії, закупівлю, допомогу у наданні позик, а також фіскальні інвестиції та фінансування, з акцентом на їхній ролі у зниженні операційних витрат, управлінні розподілом капіталу, сприянні зайнятості та стимулюванні інновацій та експорту.

Виокремлено ключові переваги фіскальної підтримки: покращений доступ до фінансових ресурсів, сприяння формалізації, створення робочих місць, підвищена стійкість під час криз та доступ до розширених ринків через державні інвестиції та закупівлі. До недоліків фіскальної підтримки віднесено ризик пасток зростання через стимули, що базуються на розмірі підприємства, спотворення ринку, збільшення фіскального навантаження, неефективність впровадження та відсутність зосередженості на довгострокових структурних реформах.

Аналіз поточної макроекономічної динаміки Китаю дозволив виокремити тенденції споживання, реалізації фіскальної політики, моделі оподаткування та показники розвитку економіки. Зокрема зазначено, що зростання споживання залишається стриманим через підвищені запобіжні заощадження з помітним зниженням цін на транспортні та телекомунікаційні послуги. Дослідження показало, що управління боргом центрального уряду в Китаї дотримується консервативної стратегії, що призводить до порівняно низького його рівня. Натомість місцеві органи влади продовжують мати хронічний дефіцит, що вимагає змін політики бюджетування. Сучасна фіскальна політика Китаю стала більш експансіоністською, що характеризується випуском довгострокових облігацій для фінансування проектів критичної інфраструктури. Подальший аналіз показав, що нещодавні фіскальні втручання центрального уряду спрямовані на пом’якшення середньострокових структурних ризиків, пов’язаних з фіскальними труднощами місцевих органів влади, що стимулюють економічну активність та протидіють дефляційним тенденціям.

У дослідженні зроблено висновок, що хоча фіскальна та промислова стратегії Китаю визначають обережні цілі зростання, основні структурні та фінансові дисбаланси залишаються, особливо на субнаціональному рівні. У дослідженні виокремлено структурні та фінансові проблеми, з якими стикаються мікро та малий бізнес у Китаї, особливо після COVID-19. Зокрема виявлено, що ММП продовжують стикатися зі значними перешкодами в доступі до приватного фінансування, головним чином через те, що їх сприймають як високоризиковані та низькорентабельні підприємства. В роботі зазначено, що процентні ставки для ММП дещо знизилися порівняно з великими підприємствами. Крім того, спостерігалося розширення підтримки швидкозростаючих ММП та «компаній-єдинорогів» у рамках зусиль щодо сприяння новій, високоякісній продуктивності.

Показано, що за останнє десятиліття кількість приватних підприємств у Китаї зросла більш ніж у чотири рази, і зараз становить понад 96% від загальної кількості підприємств. Подальший аналіз показав зв’язок між середньою заробітною платою та зростанням кількості корпоративних підприємств. Було встановлено сильну позитивну кореляцію (з коефіцієнтами вище 0,9), що вказує на те, що зростання заробітної плати тісно пов’язане з розширенням підприємств. На цей зв’язок впливають такі економічні чинники, як рівень освіти, попит на кваліфікацію, вартість життя та промисловий розвиток. У дослідженні зроблено висновок, що динаміка заробітної плати та зростання підприємств взаємно підсилюють одне одного та відображають поточну структурну трансформацію економіки Китаю.

У дисертації розроблено заходи для посилення розвитку мікро- та малих підприємств у Китаї, зокрема встановлено, що впровадження ініціатив з розбудови їх потенціалу ефективно вирішує існуючу нерівність, з якою стикаються ММП, особливо ті, якими керують жінки. Особливо підкреслено, що інклюзивна фіскальна політика, така як зниження податків для жінок-підприємців, може допомогти пом’якшити гендерну нерівність у доступі до економічних можливостей. У дослідженні запропоновано конкретні стратегії коригування фіскальної політики, спрямовані на підтримку ММП, включаючи адаптивне оподаткування, яке передбачає використання гнучкої податкової політики, адаптованої до розміру фірми, економічного контексту або потреб конкретного сектору. Зазначено, що інтеграція цифрової економіки, зокрема технологій електронної комерції, штучного інтелекту та хмарних обчислень значно підвищують операційну ефективність та охоплення ринку ММП.

У дослідженні розглянуто механізми зеленого та сталого фінансування, такі як зелені позики та облігації, які виявилися життєво важливими для допомоги ММП у відповідності до глобальних програм сталого розвитку. Наявність фінансових ресурсів, зокрема доступних позик та грантів, є критичним фактором зростання, стійкості та інноваційного потенціалу ММП. Ці висновки підкреслюють необхідність скоординованих політичних зусиль для сприяння інклюзивній, адаптивній та сталій екосистемі ММП. У дослідженні обґрунтовано ключові компоненти фіскально стійких стратегій реагування на кризу, включаючи доступність, передбачуваність, ефективне таргетування, стійкість до зловживання та зворотність. Встановлено, що пріоритетність політики та обмеження дублюючих заходів підвищують ефективність, особливо в середовищах з надійними системами соціального захисту. За їх відсутності перевагу варто надавати вузько спрямованим заходам.

В роботі запропоновано послідовність переходу від тимчасового пом'якшення цін до впровадження вуглецевих податків, посилення цільового соціального захисту вразливих домогосподарств, оподаткування непередбачених прибутків в секторі викопного палива, інвестування у відновлювану енергетику та підтримання країни з низьким рівнем доходу за допомогою міжнародної допомоги. В роботі запропоновано стратегічні напрямки розвитку фіскальної політики Китаю, до яких віднесено: цільові податкові стимули для конкретних галузей, регіонів або моделей поведінки; такі як фінансові інструменти, гранти та субсидії на інновації, для сприяння дослідженням та розробкам і технологічному прогресу; пріоритети державних закупівель, що підтримують місцевих, дрібних або сталих виробників; антициклічну фіскальну політику для пом'якшення економічних коливань; регіональну та глобальну фіскальну координацію для вирішення транскордонних проблем, включаючи зміну клімату та економічну нестабільність. Дані пропозиції можуть бути ефективними інструментами для підвищення фіскальної стійкості та довгострокової економічної стабільності.

В роботі розроблено комплексну модель фіскальної політики, спрямовану на сприяння розвитку ММП у Китаї, що включає цілісну стратегію фінансової підтримки, зниження податкового навантаження та створення сприятливого бізнес-середовища, прямі фіскальні субсидії (включаючи гранти на дослідження та розробки, субсидії на зайнятість та підтримку цифрової трансформації), надання розширеного доступу до фінансування через кредитні гарантії, субсидії на відсотки. Зазначено, що зниження адміністративних та операційних витрат шляхом скасування зборів, підтримки орендної плати та комунальних послуг, а також спрощеного регулювання сприяє життєздатності бізнесу.

Також важливим є посилення ринкового попиту ММП через квоти на державні закупівлі, включення до ланцюгів постачання та підтримку експорту. Зазначено, що ефективними інструментами збалансованого зростання є регіонально- та галузево-специфічні втручання, особливо у сільських та слаборозвинених районах. Фінансовий нагляд та антимонопольне законодавство мають вирішальне значення для забезпечення конкуренції, включаючи заходи щодо вирішення проблем прострочених платежів та концентрації ринку. В роботі доведено, що підтримка цифровізації та зеленого переходу підвищує конкурентоспроможність та стійкість ММП, що включає фіскальні стимули, субсидії на зелені технології та навчання в галузі електронної комерції. На основі виявлених тенденцій виокремлено шляхи зростання, такі як бізнес-моделі на основі штучного інтелекту, низьковуглецевий перехід, відродження сільської економіки, персоналізовані моделі споживання, транскордонна електронна комерція, фінтех-інновації та гібридні моделі роботи. Запропонована комплексна модель фіскальної політики об'єднує цільові стимули та підтримку ліквідності, субсидії на підвищення стійкості, стимули для інновацій та інклюзивну підтримку вразливих та сільських мікро та малих підприємств, формуючи надійну основу для сприяння інклюзивному та сталому розвитку цих підприємств.

**Ключові слова:** фіскальна політика, сталий розвиток, мікро- та малі підприємства (ММП), субсидії, зайнятість, цифрова трансформація, глобальна економічна криза, зелений перехід, інвестиції, інновації, податкові пільги, структурна реформа, міжбюджетні відносини.

## ANNOTATION

***Zhu LIHONG*. The impact of fiscal policy on small and micro enterprises under global economic crisis**. – Qualifying thesis manuscript copyright.

Dissertation for the degree of Doctor of Philosophy in specialty 292 – “International Economic Relations” – West Ukrainian National University, Ternopil, 2025.

The dissertation offers a new solution to an important scientific and applied objective – substantiation of the theoretical and methodological foundations of the fiscal policy and the concept of its transformation under the global economic crisis and developing a comprehensive fiscal policy model aimed at promoting the development of small and micro-enterprises in China.

The study analyzed the macroeconomic foundations of fiscal policy, specifically using empirical research methods to show the evolution of fiscal policy theories. The study showed the role of automatic fiscal policy stabilizers in developed and developing economies. The study proved that the effectiveness of fiscal response depends on the government’s fiscal capacity and the economic context, especially in scenarios characterized by inflation or external deficit, where its stimulation may be ineffective. The paper showed that fiscal policy significantly affects aggregate demand, wealth distribution, and production potential. In particular, it noted the dichotomy between short-term fiscal interventions aimed at stimulating demand during downturns and long-term goals such as increasing national savings and investment.

The dissertation examines the environment, operational structure, and classification of micro and small enterprises (MSEs); it is established that donor and development organizations recognize the transformation of the business environment as vital for overcoming the challenges faced by MSEs. The above allowed for the identification of priority areas for reform, including simplifying business registration, improving tax administration, access to the judicial system, and mechanisms for dialogue between the public and private sectors. It is shown that political instability and limited institutional capacity in developing countries hinder reform progress.

The impact of gender-specific legal and cultural barriers on women-led MSEs was also highlighted. The analysis of theoretical models underlying business environment reform for MSEs includes the "level playing field" theory, which defines equal treatment for all businesses, the "differentiated approach" supporting tailored reforms for smaller firms, and the formalization theory, which argues that improving the business environment can incentivize informal MSEs to become formal.

The study examined the effectiveness and limitations of financial and fiscal support mechanisms aimed at micro and small enterprises. In particular, it was found that individual financial assistance to enterprises is not always sufficient, and numerous sectoral information platforms have poor communication, leading to delays in information exchange, which reduces the timeliness and relevance of funding opportunities. The study analyzed various forms of state support, including financial subsidies, procurement, loan assistance, as well as fiscal investments and financing, with an emphasis on their role in reducing operating costs, managing capital allocation, promoting employment, and stimulating innovation and exports.

Key advantages of fiscal support are highlighted: improved access to financial resources, promotion of formalization, job creation, increased resilience during crises, and access to expanded markets through government investments and procurement. Disadvantages of fiscal support include the risk of growth traps due to size-based incentives, market distortions, increased fiscal burden, implementation inefficiency, and lack of focus on long-term structural reforms.

An analysis of China's current macroeconomic dynamics has allowed for the identification of trends in consumption, fiscal policy implementation, taxation models, and economic development indicators. Specifically, it was noted that consumption growth remains subdued due to increased precautionary savings, with a noticeable decrease in prices for transportation and telecommunications services. The study showed that the central government's debt management in China follows a conservative strategy, resulting in a relatively low level of debt. In contrast, local authorities continue to experience chronic deficits, requiring changes in budgeting policy. China's current fiscal policy has become more expansionary, characterized by the issuance of long-term bonds to finance critical infrastructure projects. Further analysis showed that recent fiscal interventions by the central government are aimed at mitigating medium-term structural risks associated with the fiscal difficulties of local authorities, stimulating economic activity and counteracting deflationary trends.

The study concluded that while China's fiscal and industrial strategies set cautious growth targets, underlying structural and financial imbalances remain, particularly at the subnational level. The study highlighted the structural and financial challenges faced by micro and small businesses in China, especially after COVID-19. Specifically, it found that MSEs continue to face significant obstacles in accessing private financing, mainly due to being perceived as high-risk and low-profit enterprises. The paper noted that interest rates for MSEs have slightly decreased compared to large enterprises. Additionally, there has been an expansion of support for fast-growing MSEs and "unicorn companies" as part of efforts to promote new, high-quality productivity.

It is shown that over the past decade, the number of private enterprises in China has more than quadrupled, and now accounts for over 96% of the total number of enterprises. Further analysis showed a relationship between average wages and the growth in the number of corporate enterprises. A strong positive correlation was found (with coefficients above 0.9), indicating that wage growth is closely related to enterprise expansion. This relationship is influenced by economic factors such as education level, demand for skills, cost of living, and industrial development. The study concluded that wage dynamics and enterprise growth are mutually reinforcing and reflect the current structural transformation of the Chinese economy.

The dissertation developed measures to strengthen the development of micro and small enterprises in China, specifically establishing that the implementation of capacity-building initiatives effectively addresses the existing inequality faced by MSEs, especially those managed by women. It was particularly emphasized that inclusive fiscal policies, such as tax reductions for women entrepreneurs, can help mitigate gender inequality in access to economic opportunities. The study proposed specific strategies for adjusting fiscal policy aimed at supporting MSEs, including adaptive taxation, which involves using flexible tax policies tailored to firm size, economic context, or the needs of a specific sector. It was noted that the integration of the digital economy, particularly e-commerce technologies, artificial intelligence, and cloud computing, significantly increases the operational efficiency and market reach of MSEs.

The study examined green and sustainable financing mechanisms, such as green loans and bonds, which proved vital in helping MSEs align with global sustainable development agendas. The availability of financial resources, particularly accessible loans and grants, is a critical factor for the growth, resilience, and innovation potential of MSEs. These findings underscore the need for coordinated policy efforts to foster an inclusive, adaptive, and sustainable MSE ecosystem. The study substantiated the key components of fiscally sustainable crisis response strategies, including accessibility, predictability, effective targeting, resilience to abuse, and reversibility. It was found that prioritizing policies and limiting overlapping measures enhance effectiveness, especially in environments with robust social protection systems. In their absence, narrowly targeted measures should be preferred.

The paper proposes a sequence for transitioning from temporary price mitigation to implementing carbon taxes, strengthening targeted social protection for vulnerable households, taxing windfall profits in the fossil fuel sector, investing in renewable energy, and supporting low-income countries with international aid. The dissertation proposes strategic directions for the development of China's fiscal policy, which include: targeted tax incentives for specific industries, regions, or behaviours; financial instruments, grants, and subsidies for innovation to promote research and development and technological progress; government procurement priorities that support local, small, or sustainable producers; counter-cyclical fiscal policy to mitigate economic fluctuations; regional and global fiscal coordination to address cross-border issues, including climate change and economic instability. These proposals can be effective tools for enhancing fiscal sustainability and long-term economic stability.

The study develops a comprehensive fiscal policy model aimed at promoting the development of MSEs in China, which includes a holistic strategy of financial support,

tax burden reduction, and the creation of a favourable business environment, direct fiscal subsidies (including R&D grants, employment subsidies, and support for digital transformation), providing expanded access to financing through credit guarantees, and interest subsidies. It is noted that reducing administrative and operating costs by abolishing fees, supporting rent and utility payments, and simplifying regulations contributes to business viability.

Strengthening market demand for MSEs through government procurement quotas, inclusion in supply chains, and export support is also important. It is noted that regionally and sector-specific interventions, especially in rural and underdeveloped areas, are effective tools for balanced growth. Financial supervision and antitrust legislation are crucial for ensuring competition, including measures to address issues of overdue payments and market concentration. The paper proves that supporting digitalization and the green transition increases the competitiveness and resilience of MSEs, which includes fiscal incentives, subsidies for green technologies, and e-commerce training. Based on the identified trends, growth paths are highlighted, such as AI-based business models, low-carbon transition, rural economy revitalization, personalized consumption models, cross-border e-commerce, fintech innovations, and hybrid work models. The proposed comprehensive fiscal policy model combines targeted incentives and liquidity support, resilience-enhancing subsidies, innovation incentives, and inclusive support for vulnerable and rural micro and small enterprises, forming a solid foundation for promoting the inclusive and sustainable development of these enterprises.

**Keywords:** fiscal policy, sustainable development, micro and small enterprises (MSEs), subsidies, employment, digital transformation, global economic crisis, green transition, investments, innovations, tax incentives, structural reform, intergovernmental fiscal relations.

## СПИСОК ОПУБЛІКОВАНИХ ПРАЦЬ ЗА ТЕМОЮ ДИСЕРТАЦІЇ

### Наукові праці, в яких опубліковані основні наукові результати дисертації:

1. Zhu Lihong. Fiscal policy transformation under global economic crisis. *Вісник економіки*. 2024. Вип. 4. С. 227-237. URL: https://doi.org/10.35774/visnyk2024.04.227 (0,9 д.а.).
2. Zhu Lihong. *Small and Medium-Sized Enterprises in PRC Under Crisis. Journal of European Economy*. Volume 23, Issue 4. 2024. URL: https://doi.org/10.35774/jee2024.04.654 (0,9 д.а.).
3. Zhu Lihong. The impact of China's fiscal policy on real GDP growth and net government lending. *Інноваційна економіка*. 2024. Вип. 4. С. 252-260. URL: https://doi.org/10.37332/2309-1533.2024.4.29 (0,9 д.а.).
4. Zhu Lihong. Study on Fiscal Policies for Small and Micro Enterprises under the Economic Crisis. *Financial Engineering and Risk Managemen*. Clausius Scientific Press, Canada, 2023. Vol. 6 No. 3., pp. 34-40. URL: http://dx.doi.org/10.23977/ferm.2023.060306 (0,4 д.а.).

### Наукові праці, які засвідчують апробацію матеріалів дисертації:

5. Zhu Lihong. Theoretical analysis of the financial policy of small and micro enterprises under the global economic crisis. Матеріали XIX Міжнародної науково-практичної конференції молодих вчених *«Економічний і соціальний розвиток України в XXI столітті: національна візія та виклики глобалізації»*. Тернопіль: ЗУНУ, 2022. С. 27-30. (0,2 д.а.).
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7. Zhu Lihong. Research on small and micro enterprises under economic crisis. Матеріали XX Міжнародної науково-практичної конференції молодих вчених *«Економічний і соціальний розвиток України в XXI столітті: національна візія та виклики глобалізації»*. Тернопіль: ЗУНУ, 2023. С. 65-67. (0,18 д.а.).
8. Zhu Lihong, Roman Zvarych. The impact of fiscal policy on small and micro enterprises under the global economic crisis. Матеріали XVI Міжнародна науково-практичної конференції молодих учених і студентів *«Інноваційні процеси економічного і соціально-культурного розвитку: вітчизняний та зарубіжний досвід»*. Тернопіль: ЗУНУ, 2023. С. 94-96. (0,18 д.а., особисто автору – 0,1 д.а.: автором обґрунтовано антикризові заходи в умовах глобальної кризи).
9. Zhu Lihong. Study on fiscal policies for small and micro enterprises under the economic crisis. Матеріали XVII Міжнародної науково-практичної конференції молодих учених і студентів *«Інноваційні процеси економічного та соціально-

*культурного розвитку: вітчизняний та зарубіжний досвід»*. Тернопіль: ЗУНУ, 2024. С. 126-128. http://dspace.wunu.edu.ua/handle/316497/50076 (0,18 д.а.).

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**CONTENT**

# INTRODUCTION

**Actuality of theme.** The global economy encounters repeated crises, including the 2008 financial collapse, the economic downturn caused by COVID-19 in 2020, and possible disruptions in 2025 due to trade conflicts or commodity shocks, all of which disproportionately affect small and micro enterprises. Businesses classified as having fewer than 50 employees or generating less than $2 million in revenue account for 40-50% of global GDP and 60-70% of employment. However, their susceptibility to economic downturns, highlighted by closure rates of 20-30% during previous crises, emphasizes the essential role of fiscal policy in ensuring their survival and growth. Investigating the effects of fiscal policy on micro and small-sized enterprises during global crises is particularly pertinent given their economic importance, the rising occurrence of such crises, and the changing landscape of fiscal measures. Micro, small, and medium enterprises serve as the foundation of economies by fostering job creation, innovation, and social stability. Fiscal measures, including tax incentives, loans, and grants, have a direct impact on the survival of MSEs. Analyzing these interventions provides insights into how fiscal strategies can alleviate losses and support economic growth, highlighting the importance of this subject for policymakers.

The frequency and complexity of global economic crises are increasing, influenced by trade conflicts, pandemics, climate disruptions, and geopolitical strains. The IMF has cautioned about a possible economic slowdown in 2025, predicting a potential 10% contraction in global trade as a result of tariffs between the U.S. and China or surges in energy prices. Micro, small, and medium enterprises, which typically operate with less than one month of liquidity and have limited reserves, are particularly vulnerable. Conducting research on the fiscal implications at this juncture is crucial, as governments require data-driven strategies to effectively manage future disruptions, especially concerning MSEs. Although significant, research on the impact of fiscal policy on micro and small-sized enterprises during crises is still disjointed. Existing studies tend to concentrate on larger corporations or overall economic indicators, neglecting the intricacies at the micro level. A thorough examination of fiscal instruments such as loans, tax incentives, and grants in various contexts could address these deficiencies, providing valuable guidance for governmental bodies and development banks.

Investigating the effects of fiscal policy on micro and small-sized enterprises during global economic crises is particularly relevant given their significant economic role, susceptibility to disruptions, and the changing fiscal environment. As crises become more frequent and MSEs play a crucial role in job creation and innovation, it is essential to comprehend how fiscal measures such as stimulus packages, tax relief, or digital incentives can provide support. This research aims to guide the development of fair and effective policies, bridging academic gaps and meeting practical requirements. This problem actualizes the research of impact of fiscal policy on small and micro enterprises under global economic crisis and requires the development of applied model for elimination the future challenges.

**Analysis of recent research and publications.** Numerous scholars have conducted research on the transformation of fiscal policy. Zh. Harbar, V. Harbar, S. Sobchuk, O. Menchynska have provided a rationale for the transformation of the financial system, emphasizing the need for enhanced fiscal transparency, a reduction in the tax burden associated with labor resources, and the improvement of mechanisms to ensure compliance with fiscal regulations. Skott P. explored the idea that adaptations of 'functional finance' for developing economies should focus on stabilizing both the level and composition of demand in line with a target growth rate for the modern sector. Yawei Qi, Xianya Zou, and Mo Xu applied a projection pursuit model combined with the entropy method to evaluate industrial green transformation and fiscal decentralization in China. L. Lysiak concluded that extending the assessment period for the dynamics observed during the 2021-2022 crisis allowed for the identification of qualitative shifts in fiscal indicators, all while preserving their cyclical nature. Zheng Li, Shan Gao, and Shunfeng Song identified three key mechanisms through which the pilot policies influenced the digital transformation of enterprises: promoting green technological innovation, requiring greater transparency in environmental information, and driving progress through the development of green finance.

I. Chugunov, M. Pasichnyi, V. Koroviy, T. Kaneva, and A. Nikitishin examined the coordination of fiscal and monetary policies, emphasizing that it should aim to enhance public welfare and ensure long-term macroeconomic stability. Weidong Chen and Xiaohui Yuan found that financial inclusion in China has made notable progress in recent years, evolving into a distinctive and sustainable development model supported by favorable policies, regulations, and the swift advancement and adoption of digital technologies. Xiaohua Sun, Junlin Ren, and Yun Wang analyzed the distinct roles of specific and ad valorem taxes in mitigating the resource curse; using a difference-in-difference model, they empirically assessed the impact of resource taxation on economic growth and the resource curse. Chowdhury’s study revealed that the effects of the financial crisis varied across regions and were not experienced uniformly around the world. Liu (2013) identified that MSEs play an important role in the modern market economy; however, they face significant challenges within their financing systems. Naradda, Ekanayake, Abeyrathne, Prasanna, Jayasundara, and Rajapakshe carried out a critical review of existing literature to explore the global challenges faced by MSEs and to gain insights into the strategies behind their survival and success in today’s competitive business landscape. Guo, Yang, and Huang, drawing on data from a survey of 518 Chinese MSEs, examined the relationship between enterprise digitalization and their responses to public crises. Liu and Tai conducted an in-depth analysis of how rising labor costs, the appreciation of the Chinese Yuan (CNY), and the 2008 Global Financial Crisis have impacted the performance of MSEs in China.

Separate issues of development the fiscal policy and small and micro enterprises under global economic crisis are highlighted in the works of a number of scientists, in particular:

R. Brown, A. Rocha, S. Cheng, J. Cimadomo, E. Eyvaz-Zada, M. Estevao, H. Guo, Ph. Heimberger, I. Dernova, J. Seyfullali, G. Jin, A. Kuckertz, L. Liou-Yuan, X. Liu, L. Lysiak, M. Ustymenko, N. Yaroshevych, I. Kondrat, T. Kalaitan, O. Lukianykhina, S. Suprunenko, A. Slavkova, P. Chen, S. Berset, M. Huber, T. Chernychko, M. Ihnatyshyn, T. Kalaitan, O. Hrymak, L. Kushnir, O. Sarakhman,

V. Loiko, B. Aleksandrov, X. Liu, X. Sun, Y. Shi, O. Bala, Yu. Danko, A. Ivanova, O. Sokhatska, F. Tkachyk, R. Zvarych.

At the same time, the mentioned studies and publications do not sufficiently reveal the process of environmental sustainability of PRC international trade, which determines the relevance of this scientific study.

**Connection of research with scientific programs, plans, topics.** The dissertation is a component of scientific research of the West Ukrainian National University, in particular: fundamental state budget funding researche "Concept of recovery and green reconstruction of Ukraine" (state registration number 0124U000003); implementation of the international project (Erasmus+ Module Jean Monnet) "European inclusive circular economy: post-war and post-pandemic module for Ukraine (EICEPPMU)" 2022-2025, registration number 101085640); business funding research on the topic "Formation of the company's ecological brand in foreign markets" (Contract No. MEV-37-2024 dated 25/04/2024); business funding research on the topic "Transformation of business in conditions of sustainable development of the global economy" (Contract No. MEV-33-2023 dated 05/10/2023). The results of research have been used and implemented by Jui quan Xing rongtong Accounting Agency Co. Ltd (Certificate JUI No. 21 dated 24/04/2025). The results obtained in the research have been used and implemented in the process of forming and implementing the economic and social development program of Jui quan Vocation Technical College School of Economics and Management Ltd (Certificate JUI No. 19 dated 24/04/2025).

**The purpose and objectives of the research.** The purpose of the dissertation is the scientific substantiation of the theoretical and methodological foundations of fiscal policy and the concept of its transformation under global economic crisis and the development of a comprehensive model of fiscal policy aimed at promoting the development of small and micro enterprises in China.

Based on the purpose of the research, the following objectives are set in the research:

- to research the macroeconomic genesis of fiscal policy;

- to define the environmental and structure of functioning and classification of micro and small enterprises;
- to research the role of fiscal policy for micro and small enterprises;
- to analyse the impact of China's fiscal policy on real GDP growth, net government lending and its transformation under global economic crisis;
- to evaluate the status and role of micro and small-sized enterprises in PRC under crisis;
- to analyse the geopolitical risks and internal challenges of fiscal policy impact on micro and small enterprises in China;
- to define the ways of policy adjustments the development of MSEs in China;
- to propose the directions of fiscal policy transformation and development under global economic crisis;
- to elaborate the fiscal policy model for the development of micro and small enterprises.

**The object of research** is a fiscal policy and small and micro enterprises.

**The subject of research** is a set of theoretical and applied aspects that determine the process of impact the fiscal policy on small and micro enterprises under global economic crisis.

**Methods of research**. To achieve the defined purpose, the dissertation thesis used a set of research methods (theoretical, historical, empirical, and others), the unity of which made it possible to fulfil all the outlined tasks. The following methods are used in the dissertation: the method of theoretical generalization (to systematize the macroeconomic genesis of fiscal policy), the historical method (to determine the environment and structure of functioning, as well as the classification of micro and small enterprises), the method of dialectical cognition (to study the role of fiscal policy for micro and small enterprises), the method of analogies and comparative analysis (to analyze the impact of China's fiscal policy on real GDP growth, net government lending and its transformation in the context of the global economic crisis), the methods of induction and deduction (to formulate ways to adjust policy for the development of MSEs in China), the methods of analysis, synthesis and data processing (to assess the state and role of micro and small enterprises in the PRC in the context of the crisis), the monitoring method (to analyze geopolitical risks and internal challenges of the impact of fiscal policy on micro and small enterprises in China), and the method of data visualization (to graphically present key provisions and research results).

The theoretical and methodological basis of the study was the scientific works of leading economists, statistical data and analytical materials of the World Trade Organization (WTO), the International Labor Organization (UN), the United Nations Conference on Trade and Development (UNCTAD), the International Monetary Fund, the National Bureau of Statistics of China, other international organizations and think tanks, national business development strategies, legislative acts of developed countries on the development of small and microenterprises, scientific articles by scientists, monographs, and Internet resources.

**Scientific novelty of the research results** consists in establishing scientific substantiation of the theoretical and methodological foundations of fiscal policy and the concept of its transformation under global economic crisis and the development of a comprehensive model of fiscal policy aimed at promoting the development of small and micro enterprises in China.

The following most important scientific results were obtained in the research:

*for the first time:*

– developed the comprehensive fiscal policy model aimed to promoting the development of small and micro enterprises in China, which includes a holistic financial support strategy, reducing the tax burden and creating a favorable business environment, direct fiscal subsidies (including R&D grants, employment subsidies and support for digital transformation), providing expanded access to finance through loan guarantees, interest subsidies;

*improved:*

– the concept of implementing fiscal policy in the system of international economic relations by adapting organizational mechanisms to short-term and long-term objectives, combining expansionary and contractionary types of its implementation, taking into account potential challenges and threats, which made it possible to propose an appropriate structure-logic scheme that describes the cause-and-effect relationships and key factors of its transformation;

— the methodical approaches to assessing the fiscal policy of the PRC by studying indicators of real GDP growth, net government lending, budget deficit, corporate tax revenue, and profit margins, which made it possible to methodically substantiate ways to transform fiscal policy instruments and measures in the context of the global economic crisis;

— the ways to adjust the development policy of small and micro enterprises in the PRC using adaptive taxation strategies, digital economy integration, and inclusive sustainable green financing, which made it possible to form directions for fiscal policy transformation using targeted tax incentives, subsidies, innovation grants, government procurement preferences, and to justify countercyclical fiscal measures of regional and global coordination;

*further developed:*

— the research into the relationships and key factors influencing the results of fiscal policy, in particular, the environment and structure of the functioning and classification of small and micro enterprises were assessed, which made it possible to establish the integration and logical connections of the organizational structure, operational processes and strategic decisions and their interaction with the external environment;

— the substantiation of the benefits of fiscal policy stimulation and outlining potential challenges for the development of small and micro enterprises in the PRC, which made it possible to develop a mechanism for the influence of fiscal and tax policy on small and micro enterprises using tax incentives and relevant instruments of state procurement policy;

— the research into geopolitical risks and internal challenges of the impact of fiscal policy on small and micro-enterprises in the PRC, which made it possible to establish regression relationships between the growth of employee income and the increase in corporate micro-units and the behavior of economic entities in the PRC in times of crisis.

**The practical value of the results.** The practical significance of the results of the dissertation is that the main theoretical provisions of the study of the key areas of fiscal policy transformation and ways of policy adjustments the development of MSEs in China can be used in the practical activities of business units and in further scientific developments.

**Personal contribution of the applicant.** Dissertation work is self-exploration research. The theoretical propositions, proposals and results presented for defence were obtained by the author personally. From the scientific publications published in co-authorship, the work uses only those provisions that are the result of the author's personal research.

**Approbation of the results of the dissertation.** The main results of the dissertation were discussed at international scientific and scientific-practical conferences: International scientific and practical conference of young scientists "Economic and social development of Ukraine in the XXI century: national vision and challenges of globalization" (Ternopil, 2022); International scientific and practical conference of young scientists and students "Innovative processes of economic and socio-cultural development: domestic and foreign experience" (Ternopil, 2022); International scientific and practical conference of young scientists "Economic and social development of Ukraine in the XXI century: national vision and challenges of globalization" (Ternopil, 2023); International scientific and practical conference of young scientists and students "Innovative processes of economic and socio-cultural development: domestic and foreign experience" (Ternopil, 2023); International scientific and practical conference of young scientists and students "Innovative processes of economic and socio-cultural development: domestic and foreign experience" (Ternopil, 2024); International scientific and practical conference of young scientists and students "Innovative processes of economic and socio-cultural development: domestic and foreign experience" (Ternopil, 2025).

The main scientific developments regarding the model of fiscal policy for stimulating and supporting small and micro enterprises of the China will be approved by the Department of International Economic Relations in a scientific and technical report based on the results of: fundamental state budget funding research “Concept of recovery and green reconstruction of Ukraine” (state registration number 0124U000003); and business funding research on the topic “Formation of the company’s ecological brand in foreign markets” (Contract No. MEV-37-2024 dated 25/04/2024). The results of research have been used and implemented by Jui quan Xing rongtong Accounting Agency Co. Ltd (Certificate JUI No. 21 dated 24/04/2025). The results obtained in the research have been used and implemented in the process of forming and implementing the economic and social development program of Jui quan Vocation Technical College School of Economics and Management Ltd (Certificate JUI No. 19 dated 24/04/2025)

**Publications.** The main results of the dissertation research were published in 10 articles with a total volume of 4.16 p.s. (of which the author personally owns 4.0 p.s.), including: 3 – publications in Journals of category “B” of the List of scientific and specialized publications of Ukraine by specialty: 292 “International Economic Relations”; 1 – publication in international periodical scientific Journal; 6 – publications in Conference Paper Proceeding.

**The structure and volume of thesis.** The dissertation consists of an introduction, three sections, conclusions, a list of reference, and annexes. The total volume of the dissertation is 189 pages, of which 149 pages are the main text. The thesis contains 4 tables, 39 figures and 2 appendices on 7 pages. The list of reference includes 178 sources on 22 pages.

# CHAPTER 1
# THEORETICAL AND METHODOLOGICAL BASIS OF THE RESEARCH THE IMPACT OF FISCAL POLICY ON SMALL AND MICRO ENTERPRISES

## 1.1. The macroeconomic genesis of fiscal policy

Fiscal policy impacts the economy by means of government expenditure and taxation, aiming to foster sustainable growth and alleviate poverty. Its significance was particularly evident during the global economic crisis, as numerous governments took active measures to stabilize financial systems, stimulate economic activity, and shield vulnerable groups from the adverse effects of the crisis. To guide economic performance, policymakers primarily use two key instruments: fiscal policy and monetary policy. Central banks influence economic activity indirectly by regulating the money supply primarily through interest rate adjustments, changes in bank reserve requirements, and transactions involving government securities and foreign exchange. In contrast, governments exert direct influence by modifying tax rates and structures, changing the composition and scale of public expenditures, and managing borrowing strategies. Through these actions, governments play a crucial role in allocating economic resources, both directly and via indirect channels. This impact is often demonstrated using the national income accounting equation, which evaluates a country's gross domestic product (GDP) by analyzing overall expenditure patterns:

$$GDP = C + I + G + NX \qquad (1)$$

Gross Domestic Product (GDP) represents the total monetary value of all final goods and services produced within a nation's economy during a defined time frame. The components that contribute to aggregate spending and demand are: private consumption *(C)*, private investment *(I)*, government expenditures on goods and services *(G)*, and the net demand from foreign markets, represented by exports minus imports *(net exports, NX)*. This equation illustrates that government actions can influence economic activity (GDP) by directly managing *G* and indirectly affecting *C*, *I*, and *NX* through modifications in taxation, transfers, spending, and borrowing. Fiscal policy aimed at increasing aggregate demand through heightened government spending is generally referred to as expansionary or "loose". Conversely, it is often labeled contractionary or "tight" when it diminishes demand by reducing spending [44; 36].

Fiscal policy objectives can vary considerably depending on the time horizon. In the short term, governments typically emphasize macroeconomic stabilization—such as boosting spending or lowering taxes to stimulate a sluggish economy, or tightening fiscal measures to curb inflation and address external imbalances. Over the long term, the emphasis often shifts toward fostering sustainable economic growth and poverty reduction through supply-side measures, including investments in infrastructure, education, and human capital development. While these objectives may be commonly recognized across various nations, their significance can vary based on specific country conditions. Short-term fiscal priorities are often shaped by the business cycle, responses to natural disasters, or shifts in global food and fuel prices. Long-term considerations, on the other hand, tend to focus on structural factors such as economic development, demographic trends, and the availability of natural resources. For example, low-income countries may prioritize funding for primary healthcare as a means of combating poverty, while wealthier nations might focus on pension reforms to address the financial challenges posed by an aging population. In oil-rich countries, policymakers may adjust fiscal strategies to align with broader macroeconomic trends, such as moderating procyclical spending to prevent excessive expenditure during periods of rising oil prices and avoiding drastic cuts when prices fall.

The global financial crisis, which began with the collapse of the U.S. mortgage market in 2007, serves as a significant example of fiscal policy in action. The crisis triggered widespread economic disruptions, negatively impacting the financial sector and eroding consumer confidence. As a result, private consumption, investment, and international trade all critical drivers of economic output and GDP suffered sharp declines. In response, governments implemented strategies to stimulate economic activity through two main tools: automatic stabilizers and fiscal stimulus, which involves new discretionary spending or tax cuts [33; 42].

Automatic stabilizers are fiscal mechanisms that automatically adjust in response to changes in the economy, without requiring active government intervention. They are directly tied to the business cycle. For instance, during economic slowdowns, tax revenues fall due to decreased corporate profits and lower income levels, particularly in progressive tax systems that tax higher incomes at higher rates. Simultaneously, social welfare expenditures, such as unemployment benefits, rise during downturns. These automatic adjustments cause fiscal policy to become expansionary during recessions and contractionary in periods of economic growth, stabilizing the economy without the need for specific policy changes [2].

Automatic stabilizers are closely linked to the extent of government intervention and tend to be more prominent in developed economies. In countries where these stabilizers are robust, the need for additional stimulus measures, such as tax cuts, subsidies, or infrastructure projects, may be reduced, as both approaches aim to mitigate the negative effects of economic downturns. Moreover, while discretionary measures can be tailored to specific stabilization needs, automatic stabilizers have the advantage of operating without the delays typically associated with discretionary policies. For example, designing, obtaining approval for, and implementing new infrastructure projects can be a lengthy process. Additionally, the impact of automatic stabilizers gradually diminishes as economic conditions improve, automatically shifting fiscal policy toward a more neutral or contractionary stance. “Designing and implementing stimulus measures can be challenging, and reversing them when the economy recovers can also pose difficulties. In many low-income and emerging market economies, however, institutional constraints and limited tax bases result in relatively weak stabilizers. Even in nations with more robust stabilizers, there may be an urgent need to address the decline in economic activity and to direct the government's crisis response towards those who are most affected” [1; 28].

The precise response is contingent upon the available fiscal capacity for new expenditures or tax reductions, which refers to the extent to which the government can secure additional funding at a reasonable cost or its capability to reallocate existing financial resources. Some governments faced challenges in implementing stimulus measures during the crisis due to concerns from potential creditors. There was a fear that increased government spending and borrowing could intensify inflationary pressures, deplete foreign exchange reserves, or destabilize the exchange rate. These concerns led to the belief that such actions could undermine economic recovery by diverting resources away from the local private sector, a phenomenon known as “crowding out”. Additionally, creditors may have questioned the ability of some governments to allocate funds judiciously, retract stimulus measures once initiated, or rectify persistent structural deficiencies in public finances, such as chronically low tax revenues stemming from inadequate tax systems or evasion, insufficient oversight of local government or state-owned enterprise finances, escalating healthcare costs, and aging demographics. In certain instances, stringent financing limitations have compelled governments to reduce expenditures in response to dwindling revenues, acting as automatic stabilizers. In scenarios of high inflation or external current account deficits, fiscal stimulus may prove ineffective and potentially counterproductive.

The characteristics of the stimulus, including its size, timing, composition, and duration, are of significant importance. Policymakers typically strive to customize their interventions based on their assessments of the output gap, which represents the disparity between anticipated output and the economy's output at full capacity. “Additionally, it is essential to evaluate the effectiveness of the stimulus, specifically in terms of its impact on output growth, commonly referred to as the multiplier effect. Generally, multipliers are more substantial when there is minimal leakage meaning that only a small fraction of the stimulus is saved or allocated to imports when monetary conditions are supportive, and when the fiscal situation of the country post-stimulus is deemed sustainable” [2]. On the other hand, multipliers may be reduced or even negative if the expansionary policies raise concerns about the sustainability of public finances, both in the short and long term. In such cases, the private sector might respond by increasing savings or moving capital abroad, rather than increasing investment or consumption. Additionally, multipliers are generally more significant for direct government spending initiatives than for tax cuts or transfers. This is because direct spending creates immediate demand for goods and services, whereas tax cuts or transfers may not have the same immediate impact on consumption (see fig. 1.1).

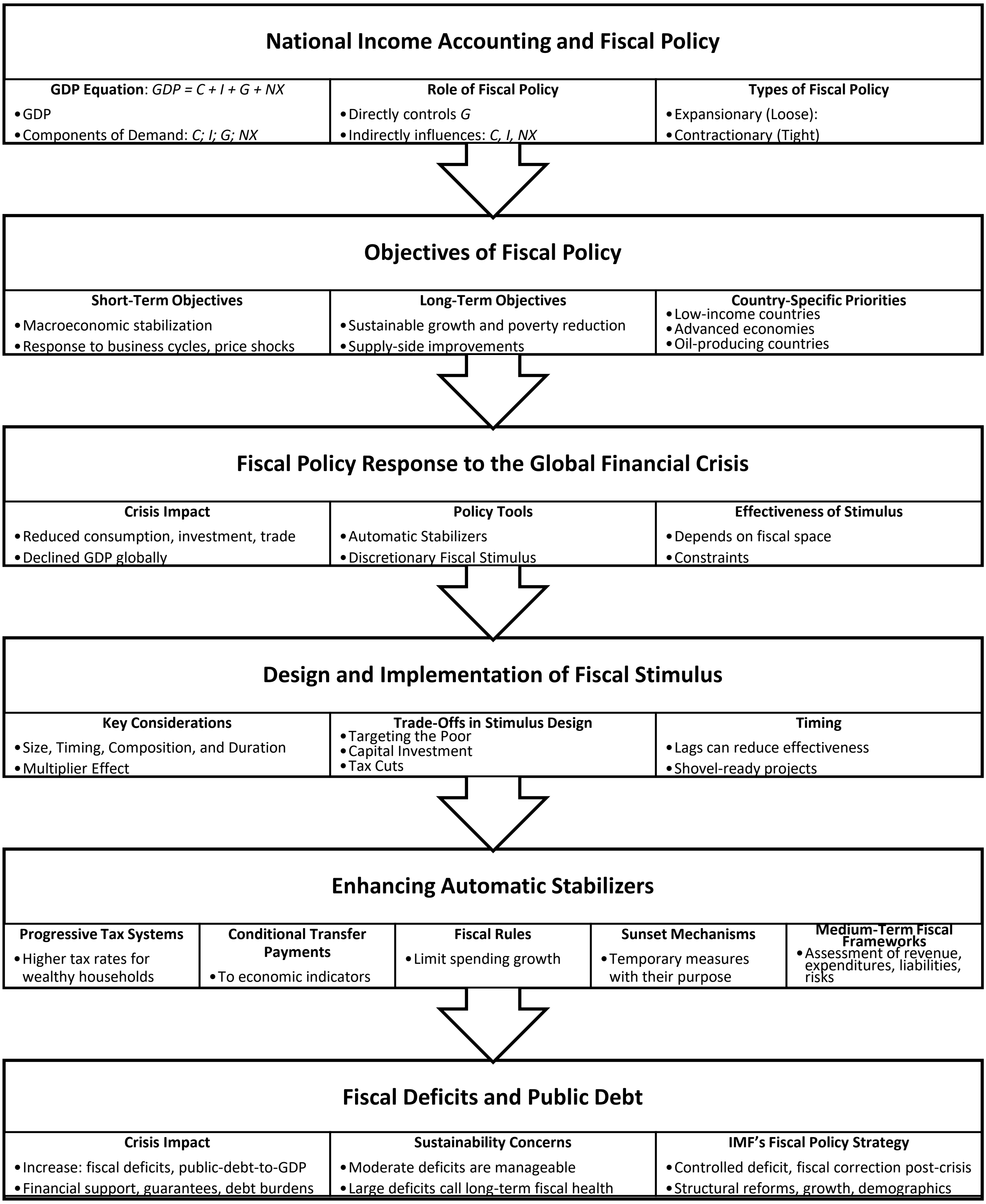


**Fig. 1.1. Organization framework of fiscal policy mechanisms and objectives**

Source: [author].

Furthermore, multipliers tend to be smaller in smaller, more open economies, as these economies are more prone to “leakage”, where a portion of the increased demand leaks out in the form of imports, reducing the overall impact of fiscal measures. Governments encounter a dilemma when deciding how to allocate stimulus funds. They can focus on assisting the impoverished, which typically results in immediate spending and significant economic impact; invest in capital projects, which can generate employment and support long-term growth; or implement tax reductions, which may stimulate hiring or the acquisition of new capital assets. In practice, governments have adopted a comprehensive strategy that encompasses initiatives across all these domains [14; 60].

Regarding the timing of these measures, the implementation of spending initiatives can be protracted due to factors such as program design, procurement, and execution. Once established, these measures may persist beyond their necessity. However, in situations where a downturn is anticipated to be extended, the urgency of addressing delays may diminish. Consequently, some governments prioritized the execution of shovel-ready projects that had already been evaluated and were prepared for implementation. This underscores the importance of ensuring that stimulus measures are timely, targeted, and temporary, allowing for a swift retraction once economic conditions improve. The effectiveness and range of stabilizers can be improved, for example, through a more progressive taxation system that imposes higher rates on affluent households compared to those with lower incomes. Additionally, transfer payments may be directly associated with economic indicators, such as unemployment rates or other labor market conditions. In certain nations, fiscal regulations are designed to restrict spending growth during periods of economic expansion, particularly when revenue from natural resources is substantial and fiscal constraints appear less stringent. In other regions, formal review or expiration mechanisms are implemented to ensure that new initiatives do not extend beyond their intended purpose. Finally, medium-term fiscal frameworks that include a comprehensive assessment of revenues, expenditures, assets, liabilities, and related risks support improved policymaking throughout the economic cycle [32].

The global crisis led to a sharp rise in fiscal deficits and public debt-to-GDP ratios in many countries, driven by shrinking GDP, reduced tax revenues, and the high costs of fiscal interventions. Government support and guarantees extended to financial and industrial sectors have further fueled concerns about long-term fiscal stability. While many countries can manage moderate deficits over time as long as financial markets and international partners remain confident in their fiscal responsibility persistent and excessive deficits risk undermining that trust. “Recognizing these risks, the IMF urged governments in late 2008 and early 2009 to adopt a comprehensive fiscal policy strategy comprising four key components to ensure solvency: stimulus measures should not lead to permanent deficits; medium-term frameworks must include a commitment to fiscal correction once conditions improve; structural reforms should be identified and executed to promote growth; and nations facing medium- and long-term demographic challenges should commit to reforms in healthcare and pensions. Although the most severe impacts of the crisis are now behind us, fiscal challenges persist, particularly in advanced economies in Europe and North America, making this strategy still relevant” [3; 127].

Fiscal policy plays a key role in influencing aggregate demand, the distribution of wealth, and the economy’s overall productive capacity. In the short term, changes in government spending or taxation can significantly affect both the volume and composition of demand for goods and services. Over the long run, these shifts in demand can shape how resources are allocated and boost economic productivity by impacting the returns on production inputs, encouraging the development of human capital, steering investment decisions, and supporting technological innovation. Furthermore, tax rates impact the net returns on labor, savings, and investments, thereby affecting both the scale and distribution of productive capacity. Macroeconomics has traditionally presented two overarching perspectives regarding the economy and the effectiveness of fiscal policy in stabilizing or influencing economic activity. The equilibrium perspective suggests that the economy quickly returns to full capacity after any disruptions to full employment. As a result, changes in fiscal and monetary policy are believed to have a limited effect on stabilizing the economy. The delays in recognizing economic disturbances, implementing fiscal measures, and the economy's response to these policies may worsen, rather than mitigate, fluctuations in the business cycle. In contrast, an alternative perspective emphasizes the presence of significant market failures that prevent the economy from adjusting effectively to disturbances. For example, if consumers decide to reduce current spending in favor of increasing future consumption, producers lacking information about consumers' future intentions due to the absence of suitable futures markets would only see a prolonged decline in demand. This could lead producers to cut back on hiring and capital investments. In such a scenario, fiscal and monetary policy adjustments are seen as having a greater potential to stabilize aggregate demand and overall economic activity. The economy's response to fiscal policy depends on whether it is operating at full employment or below its full capacity [12; 84; 64].

To highlight the importance of distinguishing between different perspectives in fiscal policy stabilization, consider the example of a reduction in personal income taxes a classic countercyclical fiscal measure. If all other factors remain constant, lower taxes increase households' disposable income, allowing for higher consumer spending. However, the actual impact of this tax cut how much of the additional income is spent versus saved, and how it influences overall economic activity depends on household behavior and the prevailing macroeconomic conditions. The perception of a tax cut as either temporary or permanent significantly impacts consumer saving behaviour. A temporary tax reduction, particularly when the economy is operating at full employment, is likely to have a minimal effect on households' lifetime disposable income, resulting in limited changes in consumption patterns. Conversely, if the tax cut is viewed as permanent, households are likely to recognize a substantial increase in their lifetime disposable income, leading to a more pronounced increase in their consumption desires compared to if they believed the cut was only temporary. Our analysis has focused on the impact of a tax reduction on household consumption expenditures, assuming all other factors remain unchanged (see fig. 1.2). Nevertheless, a reduction in taxes will lead to an increase in the government's fiscal deficit.

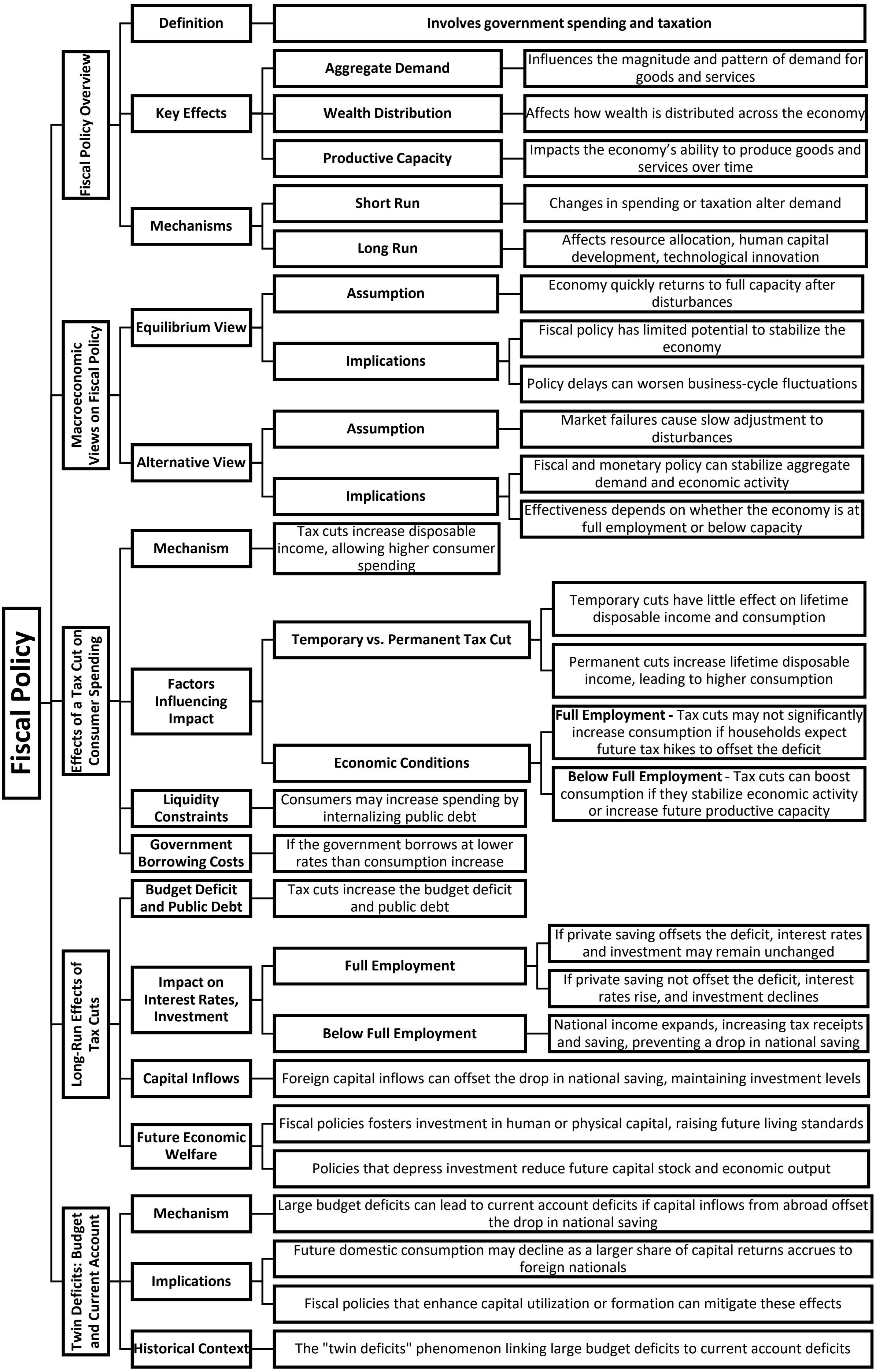


**Fig. 1.2. Structure-logic scheme of fiscal policy and its' effects** [author].

Let us consider a scenario where the economy is likely to remain close to full employment, and households do not anticipate any increase in their disposable income beyond what it would have been without the alteration in fiscal policy. Even if the tax reduction is sustained over time, many individuals may conclude that future tax rates will need to be elevated beyond what they would have been to manage the additional public debt incurred from the tax cut. In an extreme scenario, households may perceive no increase in their disposable income, as they fully account for the rise in public debt resulting from the tax cut, viewing it as analogous to personal debt. Even within the framework of full employment, it is possible for consumption to rise due to a tax reduction, particularly in the context of imperfect capital markets. Consumers facing liquidity constraints, who rely on their paychecks for daily expenses, are likely to boost their spending even if they are aware of the implications of public debt. Consequently, the impact of the tax cut will vary based on how it affects different categories of taxpayers. Additionally, consumption may also see an uptick if the government is able to secure borrowing at a lower interest rate than that available to consumers. Consumption is likely to experience a more significant increase when the economy is not operating at full employment, especially if the tax cut is seen as part of a long-term fiscal strategy aimed at stabilizing economic activity. Furthermore, if the tax reduction raises households' expected income by enhancing the economy’s future productive capacity, the impact on consumption can be further magnified. Although the tax cut results in higher public debt, the expectation of higher current and future income helps mitigate the burden of servicing or repaying this debt. In this sense, the tax cut can be viewed as an investment in a public good that ultimately benefits households [27; 74].

A tax cut that leads to a larger budget deficit will, over time, contribute to an increase in public debt. This rise in debt raises important questions about the long-term effects of the tax reduction on interest rates, capital investment, and overall economic health. Fiscal measures that expand the deficit today often imply the need for higher taxes in the future than would have been required otherwise. However, the impact of these policies on incentives for investing in human or physical capital may also contribute to an improvement in future living standards. Policies aimed at absorb lack resources or promoting investment may lead to a decrease in government savings, as indicated by a larger budget deficit, while simultaneously enhancing overall savings, as evidenced by an increased rate of capital formation. This additional savings could arise from a rise in national income or may be sourced from foreign investments. Conversely, policies that do not stimulate income and investment will not only diminish government savings but will also negatively affect total savings [194; 40].

"When the economy operates at full employment and a current tax reduction is anticipated to be counterbalanced by a future tax increase, as previously mentioned, a decrease in taxes does not automatically lead to an increase in consumption expenditure. In this scenario, any rise in the government deficit will likely be offset by an increase in private savings. Consequently, national savings, interest rates, and investment spending will remain relatively unchanged as if there had been no alteration in fiscal policy. Conversely, if consumers utilize a significant portion of their additional disposable income while the economy is already at full employment, personal savings may not increase sufficiently to counterbalance the decline in public savings" [4]. This situation would lead to rising interest rates and a decrease in investment spending, unless there is a notable increase in business savings due to heightened consumption or sufficient capital inflows from abroad to bridge the gap. "If the economy is not at full employment, a tax cut could stimulate national income, resulting in higher income tax revenues and savings, thus averting a decline in national savings. In both scenarios, a tax reduction that enhances the return on capital can boost business savings and temporarily attract foreign savings, thereby sustaining overall savings and investment levels. However, if fiscal policy adversely affects investment, the future capital stock and economic output will be diminished compared to what they could have been, leading to higher real interest rates than would otherwise prevail" [8; 162].

An increase in capital inflows from foreign sources that is substantial enough to counterbalance any decline in national savings due to changes in fiscal policy can prevent a decrease in investment. In such a scenario, the current account deficit, which corresponds to the volume of capital inflows from abroad, will rise sufficiently to offset the increase in the budget deficit, adjusted for any corresponding rise in private savings.

Consequently, while future levels of capital stock and real output may remain stable, domestic consumption is likely to diminish, as a larger portion of capital returns will be allocated to foreign investors unless the fiscal policy encourages enhanced utilization of capital stock, increased capital formation, or improved net returns on capital to mitigate the outflow. The significant budget and current account deficits observed in the early 1980s and more recently have led to the perception that substantial increases in the current account deficit typically coincide with large budget deficits, coining the definition "twin deficits" [6; 7; 163].

The previous discussion underscores a potential conflict between using fiscal policy to stimulate aggregate demand during periods of short-term economic underperformance and pursuing policies aimed at achieving long-term goals, such as increasing national savings and capital formation, which are crucial for improving future living standards. When economic resources are underutilized, fiscal stimulus can boost investment. However, as the economy nears its potential, an increase in public debt may eventually crowd out private investment, unless the fiscal stimulus is tapered as the economy approaches full employment or if the policy effectively fosters capital formation and expands the labor supply (see fig. 1.3).

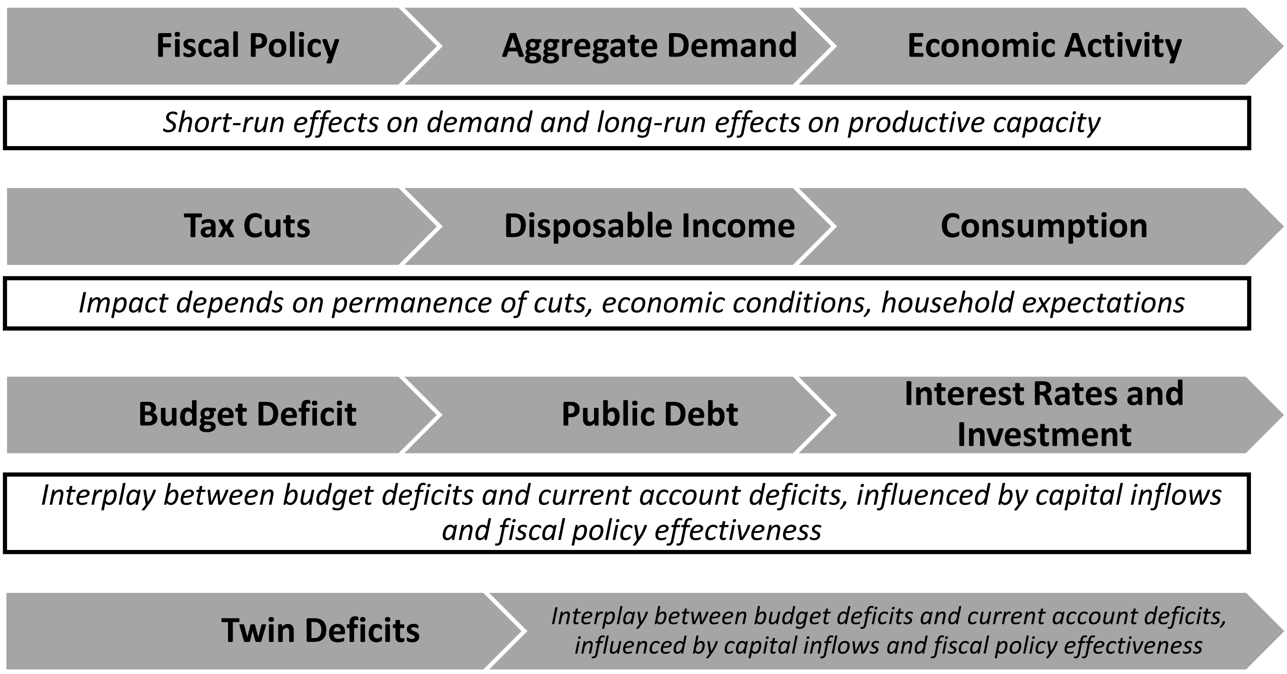


**Fig. 1.3. Relationships and key factors influencing fiscal policy outcomes**

Source: [author].

The history of theoretical descriptions of fiscal policy can be traced through several key stages of economic thought. Early economic thought takes pre-20th century period. *Mercantilism* (16th-18th Century): while not explicitly about fiscal policy, this period emphasized government control over economic activities, including taxation and spending, primarily to increase national wealth and power. *Classical Economics* (Late 18th-19th Century): figures like Adam Smith, David Ricardo, and John Stuart Mill discussed government roles in economies but primarily advocated for minimal state intervention. Fiscal policy was less about active management and more about ensuring balanced budgets over the business cycle. The theory of fiscal policy is primarily grounded in the concepts put forth by the British economist J. Keynes (1883-1946). He contended that economic downturns are a result of insufficient consumer spending and inadequate business investment within the aggregate demand framework.

*Keynesian Fiscal Policy.* This theory asserts that government involvement is essential for regulating economic fluctuations. It advocates that in periods of economic decline, governments ought to enhance expenditure or lower taxes to boost demand, which in turn can alleviate unemployment and foster growth. Conversely, during phases of economic expansion, it is recommended that the government reduce spending or raise taxes to temper the economy and avert inflation. The primary emphasis is on managing demand to attain full employment and maintain price stability. Keynesian economists argue that the private sector elements of aggregate demand exhibit significant variability and are heavily influenced by psychological and emotional factors, which hinders the ability to achieve sustained economic growth. Negative sentiments such as pessimism, fear, and uncertainty among consumers and businesses can precipitate economic downturns and depressions. Additionally, an overzealous public sector during prosperous periods may result in an overheated economy and subsequent inflation [75; 90; 91].

*Supply-Side Economics.* Supply-side economics, often referred to as "Reaganomics" because of its connection to the policies implemented by Ronald Reagan, focuses on enhancing production by minimizing obstacles for businesses. The fundamental principle is that by lowering taxes, deregulating markets, and decreasing government expenditures, individuals are encouraged to work, save, and invest. The theory posits that the advantages will ultimately "trickle down" to various segments of society through heightened employment and economic engagement (see table. 1.1).

*Table 1.1*

**The main theories of fiscal policy**

| | |
|---|---|
| **Keynesian Fiscal Policy** | |
| *Characteristics* | Advocates for active government intervention to stabilize the economy, particularly through changes in government spending and taxation. Emphasis on counter-cyclical measures: increasing spending or cutting taxes during recessions to boost demand, and reducing spending or raising taxes during booms to curb inflation. |
| *Authors* | John Maynard Keynes |
| *Period* | 1930s |
| *Advantages* | Can stimulate economic activity during downturns, reducing unemployment and promoting growth. Provides a mechanism to smooth out economic cycles. |
| *Disadvantages* | Risk of creating long-term budget deficits if not balanced properly. Potential for inflation if expansionary policies are overused. Time lags in policy implementation can misalign with economic conditions. |
| **Supply-Side Economics** | |
| *Characteristics* | Focuses on increasing the supply of goods and services through tax cuts (especially for businesses), deregulation, and reducing government spending to incentivize production and investment. Known for "trickle-down" economics where benefits for businesses and the wealthy are expected to benefit the broader economy. |
| *Authors* | Arthur Laffer, Robert Mundell, popularized by Ronald Reagan |
| *Period* | 1970s – 1980s |
| *Advantages* | Can lead to increased business investment, job creation, and economic growth if the supply-side measures stimulate productivity. Lower taxes might encourage work, saving, and investment. |
| *Disadvantages* | Can lead to larger income inequality as benefits might not "trickle down" as expected. Revenue loss from tax cuts can lead to increased government deficits unless offset by growth. Effectiveness is debated, with mixed empirical evidence on economic outcomes. |
| **Classical and Neoclassical Fiscal Policy** | |
| *Characteristics* | Advocates for minimal government intervention, believing markets are self-regulating and efficient. Fiscal policy should focus on maintaining long-term fiscal balance, and public debt should be managed conservatively. |
| *Authors* | Adam Smith, David Ricardo, Milton Friedman |
| *Period* | 18th century |
| *Advantages* | Promotes fiscal discipline, reducing the risk of inflation from excessive money supply or public debt. Advocates for lower taxes and government spending, which can stimulate private sector growth. |
| *Disadvantages* | May not effectively address short-term economic downturns, potentially leading to higher unemployment during recessions. Can overlook market failures where government intervention might be beneficial. |
| **Modern Monetary Theory (MMT)** | |
| *Characteristics* | Argues that countries with sovereign currencies can and should run deficits to achieve full employment, as long as inflation is controlled. Government spending is not constrained by tax revenue in the same way as households or businesses, but by inflation. |
| *Authors* | Warren Mosler, Randall Wray, Stephanie Kelton |
| *Period* | end of 20th – beginning of 21st centuries, particularly after the 2008 financial crisis |
| *Advantages* | Allows for significant government spending on public goods without immediate concern for budget deficits, potentially leading to full employment and social welfare. Can be used to achieve economic stability by targeting inflation rather than debt levels. |
| *Disadvantages* | Risk of high inflation if spending exceeds the economy's productive capacity. Potential for international currency depreciation if perceived as financially imprudent. Critics argue it might lead to irresponsible fiscal policy without proper checks and balances. |

Source: [author by: 21; 24; 163].

*Classical and Neoclassical Fiscal Policy.* Grounded in the principles established by Adam Smith and subsequently expanded upon by economists such as David Ricardo, this perspective asserts that markets possess a self-regulating characteristic. It promotes a philosophy of minimal governmental interference in economic affairs, prioritizing long-term fiscal stability over immediate economic variations. Proponents of classical economics advocate for reduced taxation, constrained government expenditure, and a laissez-faire stance that allows markets to self-correct. Neoclassical economics further develops these ideas by integrating contemporary economic analysis while maintaining a focus on market efficiency and cautioning against the inefficiencies or resource misallocations that can arise from government intervention. Robert Lucas and others introduced the rational expectations theory, suggesting that people anticipate government policy changes, reducing the effectiveness of fiscal policy due to anticipated behavioural changes [39].

*Modern Monetary Theory (MMT).* MMT contests traditional perspectives regarding government debt and deficits by asserting that nations with sovereign currencies do not encounter financial limitations on their spending, but rather are constrained by inflation. Proponents of MMT maintain that the government can allocate funds necessary to attain full employment without the immediate requirement to raise taxes to finance such expenditures, provided that this does not result in rampant inflation. The framework encourages government expenditure to be determined by actual resources and productive capabilities instead of being primarily influenced by deficit concerns. Furthermore, MMT posits that the primary purpose of taxation should be to manage inflation and facilitate income redistribution, rather than to support government funding. This theory, associated with economists like Stephanie Kelton and L. Randall Wray, argues that countries with sovereign currencies can fund larger deficits without defaulting, as they can always print more money. MMT posits that the real constraints are inflation rather than debt, advocating for fiscal policy to manage unemployment and economic stability. The global financial crisis reignited debates on fiscal policy, with some advocating for austerity to reduce deficits, while others argued for stimulus to foster recovery, highlighting theoretical and practical disagreements [9].

The future development of the theory of fiscal policy is likely to evolve in several key areas. The future theories might more deeply integrate behavioural economics, considering how psychological factors influence economic decisions. This could lead to more nuanced fiscal policies that account for human biases and behaviours, affecting how tax systems are designed, how public spending is allocated, and how incentives are structured. The rise of digital currencies, blockchain technology, and the broader digital economy will necessitate new approaches to fiscal policy. Taxation of digital goods and services, cryptocurrency transactions, and the regulation of digital platforms might become central issues in fiscal policy theory. As global awareness of climate change grows, fiscal policy will increasingly incorporate environmental considerations. With automation potentially displacing jobs, fiscal policy might focus more on redistribution, retraining programs, or universal basic income (UBI) schemes to mitigate inequality and unemployment. The theory will need to address how fiscal tools can smooth the transition in labour markets [15; 23; 164].

The global nature of modern business operations challenges traditional fiscal policies. There might be more emphasis on international coordination for tax policies to prevent tax evasion through profit shifting or tax havens, potentially leading to a more unified global fiscal strategy. As populations age, particularly in developed countries, fiscal policy will need to adapt to manage increasing healthcare costs and pension liabilities. This could involve new forms of taxation. The use of AI and big data analytics in crafting and evaluating fiscal policy could become more prevalent. This might help in better targeting fiscal measures, understanding their impacts in real-time, and making adjustments more dynamically. Given recent global crises, there's a push towards understanding how fiscal policy can be used not just for economic stabilization but also for building resilience against various shocks, including pandemics, financial crises, or geopolitical tensions. Future developments might place a stronger emphasis on equity, exploring how fiscal policy can address systemic inequalities not just in income but also in access to services, education, and opportunities. The trajectory of fiscal policy theory will shape by trends, requiring research, adaptation, radical rethinking of traditional economic principles [57; 58].

### 1.2. Environment and structure of functioning and classification of micro and small enterprises

The operational success and expansion of Micro and Small Enterprises (MSEs) are significantly influenced by the surrounding business conditions. These businesses frequently confront distinctive difficulties stemming from the irconstrained assets and comparatively smaller scope of operations. A difficult commercial setting, typically characterized by complex legal requirements, increased costs associated with regulatory adherence, instances of corruption, and subpar infrastructure, constitutes considerable impediments to MSEs. These enterprises encounter comparatively higher costs and risks than their larger counterparts, rendering them more susceptible to external economic fluctuations. MSEs grapple with issues such as bureaucratic corruption, restricted access to legal frameworks, and inconsistent public services, including electricity and waste management, especially in developing nations. Informality represents a significant environmental factor, as numerous micro and small enterprises (MSEs) function outside established legal frameworks due to the substantial costs and perceived minimal advantages associated with formalization. According to the International Labour Organization (ILO), informal employment accounts for 61.2% of global jobs, with MSEs constituting the majority of this sector in developing nations (ILO, 2018a). This state of informality is influenced by various elements, including inadequate governance, the marginalization of specific groups (such as women and indigenous populations), poverty, and ineffective enforcement mechanisms. These environmental conditions not only obstruct the growth of MSEs but also reinforce their vulnerability, as they often lack the bargaining power and resources necessary to effectively navigate or influence these systems [52].

Donor and development organizations acknowledge that transforming the business environment is crucial for alleviating these challenges. Important areas for reform encompass streamlining business registration processes, enhancing tax administration, improving access to the judiciary, and fostering public-private dialogue (PPD) to ensure that the perspectives of micro and small enterprises (MSEs) are taken into account. Nonetheless, it is imperative that these reforms tackle systemic issues rather than merely addressing isolated symptoms, as the interconnectedness of the business environment implies that modifications in one domain (such as taxation) can have cascading effects on others (like labour compliance). Additionally, political instability and limited governmental capacity in developing nations further complicate these initiatives, frequently hindering the momentum for reform. Gender dynamics significantly influence the micro and small enterprise (MSE) landscape, as enterprises owned by women encounter unique legal, regulatory, and cultural obstacles. There is a pressing need to advocate for a gender-focused approach in reforms, emphasizing that women-led MSEs, which are predominantly found in the informal sector, necessitate specialized support to navigate these inequitable challenges. In summary, the environmental context for MSEs presents both limitations and opportunities; while a supportive business environment can enhance their potential, existing conditions frequently hinder their growth [81; 103].

*Main Theories Underpinning MSE-Oriented Reforms.* There exist multiple theoretical frameworks regarding the necessity and methodology of business environment reforms aimed at micro and small enterprises (MSEs). A prominent theory is the “level playing field” concept, which asserts that reforms ought to provide equal advantages to all businesses, irrespective of their size, in order to promote equitable competition and stimulate economic development. This perspective suggests that the challenges faced by MSEs arise from systemic market imbalances rather than from intrinsic deficiencies within small enterprises themselves. Hallberg (2000) reinforces this viewpoint by contending that interventions targeting MSEs should aim to rectify market and institutional shortcomings that skew the distribution of firm sizes, rather than presuming that small businesses inherently deliver distinct economic advantages.

The “differentiated approach” theory posits that micro and small enterprises (MSEs) possess unique requirements stemming from their limited size and resources, thereby necessitating reforms tailored to their specific circumstances. This viewpoint supports the implementation of policies such as exemptions or preferential treatment for MSEs, including simplified tax systems, contending that a uniform policy approach imposes excessive burdens on smaller businesses. The European Union’s “Think Small

First" principle resonates with this notion, promoting the idea that policies should prioritize the needs of the majority of businesses namely MSEs without inherently disadvantaging larger enterprises [37; 82].

The theory of formalization suggests that enhancing the business environment can motivate informal micro and small enterprises (MSEs) to adopt formal status, thereby improving their sustainability and their role in economic development. Scholars such as De Soto (2000) contend that formalization can unlock access to capital and growth opportunities. However, research, including findings by Boly (2015), indicates that the results are mixed; while there may be advantages such as increased profits, these are often counterbalanced by ongoing challenges, particularly in accessing credit. Detractors caution that placing too much emphasis on formalization might neglect the significant economic function of informality, which can serve as a protective mechanism during economic shocks [35; 147].

An alternative theory is the vulnerability hypothesis, which posits that micro and small enterprises (MSEs) are particularly sensitive to adverse business conditions, such as corruption and regulatory complexity, thereby necessitating focused support. Research by Beck et al. (2005) indicates that smaller firms encounter more significant financial and legal obstacles, implying that reforms aimed at alleviating these challenges could bolster MSE competitiveness. Additionally, the systemic approach connects macro-level policy reforms with interventions at the meso- and micro levels, contending that the growth of MSEs relies on a comprehensive enhancement of the business ecosystem rather than merely addressing isolated issues. The theories in question generate discussions among donor agencies. Some agencies emphasize the importance of economic transformation rather than focusing on reforms specific to micro and small enterprises (MSEs), expressing concerns that concentrating on MSEs may divert attention from overarching growth objectives. Conversely, other agencies view MSEs as a critical perspective for identifying and tackling systemic inefficiencies, striving to achieve a balance between inclusivity and economic vitality [13; 22; 106].

*General Characteristics of MSEs.* Micro and small enterprises (MSEs) are distinguished by their limited size, numerous presence, and essential contribution to job creation, especially within developing nations. MSEs are defined as businesses situated at the lower end of the size spectrum, generally employing fewer than 20 individuals (micro: fewer than 5; small: 5-19), although definitions may differ across countries and organizations (for instance, the World Bank versus EU criteria). These entities, vastly outnumbering others, frequently constitute over nine-tenths of all enterprises within evolving areas. Their impact on job creation is considerable; globally, they're responsible for roughly 34.8% of the total workforce within small and micro-sized enterprises. MSEs find themselves especially vulnerable to external influences, given their constraints in terms of finance, personnel, and technical capabilities. This vulnerability results in a significant turnover rate, characterized by frequent establishment and closure, which is further intensified by unfavourable business conditions. Research conducted by Criscuolo et al. (2014) indicates that younger MSEs tend to create jobs, whereas their older counterparts may lead to job losses, highlighting their inherently dynamic yet precarious nature. A notable characteristic of MSEs is their informality, as many operate without registration or compliance with regulations, primarily motivated by the need for survival rather than aspirations for growth. According to the ILO (2018a), 80.9% of the global workforce is engaged in informal employment, with MSEs being particularly prevalent in the agricultural sector, where 93.6% operate informally [47; 83; 104].

Micro and small enterprises (MSEs) exhibit distinct gender-related trends, employing a higher proportion of women compared to larger corporations and acting as a gateway to formal employment opportunities for women. Nevertheless, women-owned MSEs encounter significant challenges, including restricted access to financial resources and markets, which exacerbates their vulnerability. From an economic perspective, MSEs contribute less to GDP growth and transformation than larger firms, which typically play a pivotal role in export-driven development. The phenomenon known as the "missing middle" characterized by a scarcity of mid-sized firms situated between the numerous MSEs and the prevailing large enterprises highlights this limitation, although its validity is a subject of ongoing debate. Micro and small enterprises (MSEs) exhibit significant diversity, differing across sectors such as agriculture and services, as well as in terms of their formality status. However, they collectively depend on a supportive environment to flourish. Their growth potential is limited by systemic issues, including corruption, intricate bureaucratic processes, and inadequate infrastructure. Consequently, MSEs have become a central focus for reform initiatives, even though their individual contributions may be relatively modest [18].

The organizational structure of micro and small enterprises is generally characterized by simplicity and informality, reflecting their limited size and available resources. Micro enterprises are frequently owned and operated by a single individual, known as a sole proprietor, or by a small family group. The proprietor typically assumes responsibility for all decision-making processes, encompassing both strategic planning and everyday operations. Small enterprises may consist of a small group of owners or partners, who share management responsibilities with a rudimentary division of roles (for instance, one may oversee financial matters while another manages operations). Although a basic hierarchy may develop, it remains relatively flat in comparison to larger organizations. In Ukraine, numerous micro enterprises are registered as individual entrepreneurs (FOPs – "Fizychna Osoba-Pidpryiemets"), whereas small enterprises often function as limited liability companies (TOVs – "Tovarystvo z Obmezhenoiu Vidpovidalnistiu"). Micro enterprises typically have a workforce of up to 10 individuals, which may include the owner and their immediate family, along with a few additional employees. In these settings, job roles are often diverse, with one employee potentially managing sales, inventory, and customer service simultaneously. Small Enterprises, on the other hand, employ between 11 and 50 individuals, allowing for a bit more specialization, such as distinct teams for sales and production. However, the need for flexibility remains crucial due to the limited number of staff. Employment in micro enterprises is frequently informal, with a tendency to overlook strict job descriptions. Financial resources are generally constrained, relying on personal savings, small loans, or microfinance options rather than substantial investments or equity financing. The physical assets, such as equipment and premises, are usually minimal, often consisting of rented spaces or small-scale ownership, like a shop or a home-based workshop [30] (see fig. 1.4).

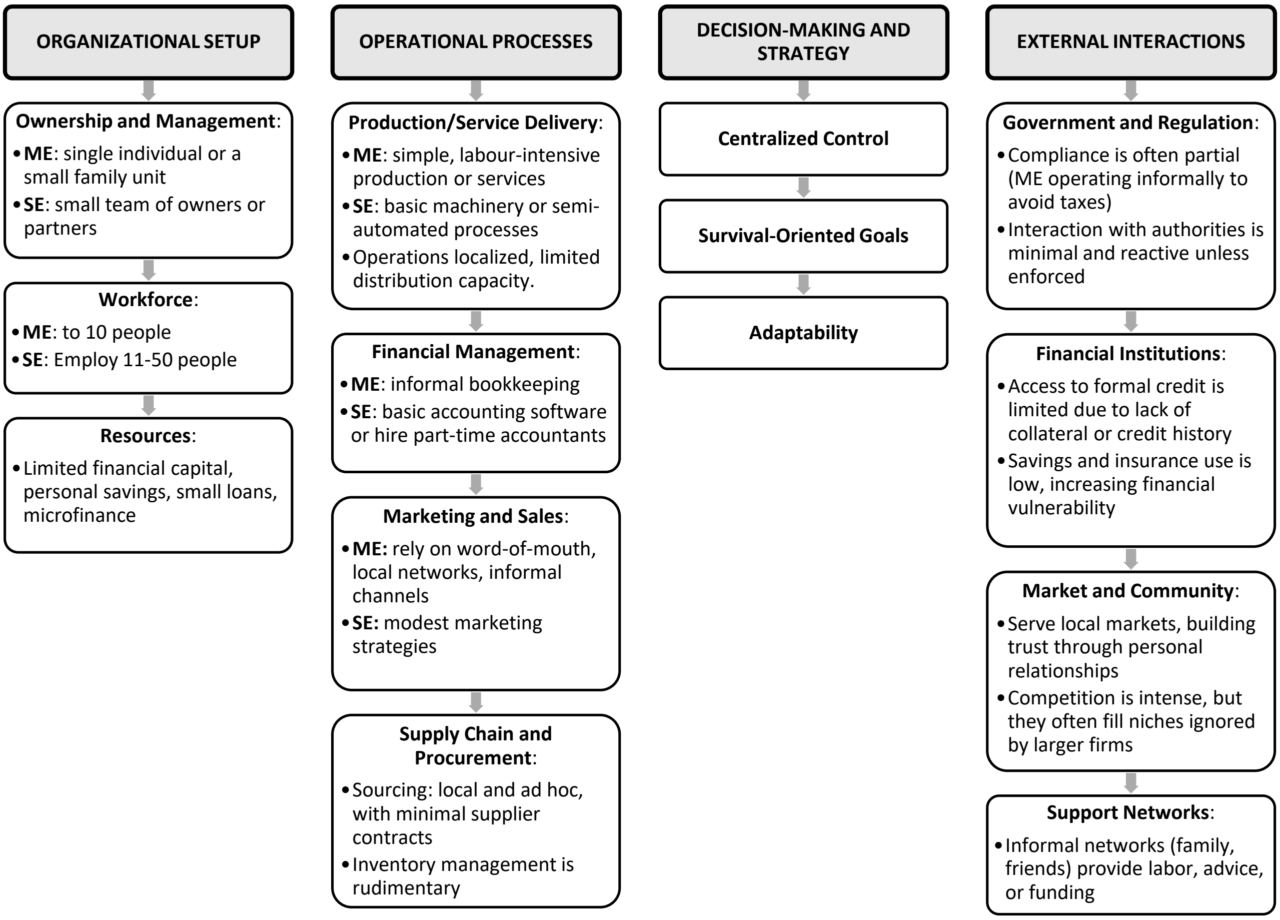


**Fig. 1.4. General structure of micro and small enterprises functioning**

Source: [author].

MSEs operate with efficient and flexible processes that are customized to their scale and the requirements of the market. Micro Enterprises primarily engage in straightforward, labour-intensive activities or services, such as tailoring, food vending, and small retail operations. Their production capabilities are constrained by manual methods and the absence of sophisticated technology. In contrast, Small Enterprises may utilize basic machinery or semi-automated systems, such as in small-scale manufacturing or bakery businesses, which enables them to achieve a modest increase in output and efficiency. Their operations are typically localized, catering to nearby markets due to restricted distribution capabilities. Informal bookkeeping practices are prevalent among micro enterprises, which typically utilize simple cash-based records instead of formal accounting systems. In Ukraine, micro enterprises operating under the Simplified Taxation System are required to submit only minimal reports. Small enterprises frequently resort to basic accounting software or engage part-time accountants to fulfil regulatory obligations, such as tax filings; however, their financial planning tends to be short-term and reactive. Marketing and sales strategies predominantly depend on word-of-mouth referrals, local networks, and informal channels, such as social media platforms like Facebook and Instagram in contemporary settings. Micro enterprises typically do not allocate funds for formal advertising. In contrast, small enterprises may implement basic marketing tactics, such as distributing flyers or utilizing local radio, to reach a slightly larger customer demographic within their vicinity. Sourcing practices are generally local and opportunistic, with few formal supplier agreements in place. Micro enterprises often procure goods from nearby wholesalers or markets, whereas small enterprises may develop fundamental relationships with consistent suppliers. Inventory management practices are basic, with stock levels kept low to reduce costs and mitigate risks [84; 105; 165].

Decision-making authority is centralized with the owner(s), indicating a deficiency in delegated power. This centralization facilitates rapid reactions to market fluctuations; however, it constrains the ability to engage in strategic planning. Micro and small enterprises tend to focus on short-term cash flow and survival rather than pursuing long-term growth objectives. Their limited scale provides the ability to adapt their offerings in response to changing consumer demands, such as a small retailer transitioning from apparel to food items during economic downturns. MSEs function within a larger ecosystem, engaging with external entities that influence their operations. Compliance with government regulations is frequently incomplete, particularly for micro enterprises that operate informally to evade taxes or bureaucratic challenges. Their interactions with authorities, such as tax offices and licensing agencies, tend to be minimal and reactive, occurring primarily when compelled. Access to formal credit is restricted due to insufficient collateral or lack of a credit history. Micro enterprises typically depend on microfinance or personal loans, while small enterprises may obtain small bank loans or government-subsidized financing. The utilization of savings and insurance is low, which heightens financial vulnerability. MSEs cater to local markets, fostering trust through personal relationships rather than brand loyalty. In rural Ukraine, for instance, micro enterprises like small farms rely heavily on community connections. Although competition among MSEs is fierce, they often occupy niches overlooked by larger companies, such as custom products and rapid services. Informal networks, including family and friends, provide essential support in terms of labor, advice, or funding [110; 166].

Basic Classification of MSEs. While a universally agreed-upon definition remains elusive, micro- and small enterprises can be classified based on various factors, including their size, degree of formality, and the surrounding environment.For clarity, let's examine a widely used categorization. The World Bank Enterprise Surveys (WBES) provide a common framework: businesses with fewer than 5 employees are classified as micro-enterprises; those with 5 to 19 employees are considered small enterprises; medium enterprises are those with 20 to 99 employees; and finally, large enterprises employ 100 or more individuals [85; 148].

Formality serves as a crucial criterion, categorizing micro and small enterprises into formal (those that are registered and adhere to regulations) and informal (those that are unregistered or only partially compliant). In developing economies, informal MSEs are prevalent, accounting for 51.9% of global informal sector employment. The level of formality influences access to advantages such as financial resources and market opportunities, with formal MSEs demonstrating greater potential for performance. The classification of micro, small, and medium enterprises differs from one country to another, as each nation establishes these classifications based on criteria such as employee count, annual revenue, and total assets. The following provides a general summary of the classification methods employed by various countries for micro and small enterprises [167].

The Chinese system for classifying micro, small, and medium enterprises relies on sector-specific rules. These rules consider several elements: the number ofpeople employed, the yearly income generated, and the overall assets a company possesses.The Ministry of Industry and Information Technology (MIIT), alongside other relevant governmental bodies, is responsible for setting these classifications. The following outlines the general classification for micro and small enterprises. Micro enterprises take fewer than 20 employees (for manufacturing – fewer than 20 employees; for wholesale trade – fewer than 5 employees; for retail trade – fewer than 10 employees; for services – 10–100 employees) with less than ¥3 million ($420,000) of annual revenue (for manufacturing – ≤ ¥3 million; for wholesale trade – ≤ ¥10 million; for retail trade – ≤ ¥5 million; for services – ≤ ¥1 million) and varies of total assets. Small Enterprises take 20–300 employees (for manufacturing – 20–300 employees; for wholesale trade – 5–20 employees; for retail trade – 10–50 employees; for services – 10–100 employees), less than ≤ ¥20 million (approximately $2.8 million) of annual revenue (for manufacturing – ≤ ¥20 million; for wholesale trade – ≤ ¥50 million; for retail trade – ≤ ¥20 million; for services – ≤ ¥10 million) and varies of total assets. In China, an enterprise is required to operate independently, indicating that it should not be a subsidiary or under the control of a larger corporation. The criteria for classification may differ somewhat based on the particular industry and local regulations. These classifications serve to establish eligibility for government assistance programs, tax benefits, and access to funding. This classification system enables the Chinese government to customize policies and support initiatives to address the specific requirements of micro and small enterprises, which play a vital role in the nation's economy [17; 140].

Within the European Union (EU), the designation of micro and small businesses hinges upon a dual criterion: the number of personnel employed, coupled with either their yearly financial turnover or the combined value of their balance sheet. This particular system of classification is officially delineated in the European Commission Recommendation 2003/361/EC. The following provides a comprehensive overview of this classification. For micro enterprises in EU staff headcount is fewer than 10 employees; annual turnover ≤ €2 million; or balance sheet total ≤ €2 million. For small enterprises staff headcount is fewer than 50 employees; annual turnover ≤ €10 million; or balance sheet total: ≤ €10 million. The staff headcount encompasses employees, apprentices, and personnel assigned to the organization. It excludes unpaid family members and owner-managers. To accurately represent the economic scale of the enterprise, turnover and balance sheet totals are utilized. Furthermore, the enterprise must maintain independence, defined as having less than 25% of its capital or voting rights held by larger entities, unless the owners are public investment corporations or institutional investors (see table 1.2).

*Table 1.2*

**The classification of micro and small enterprises across countries**

| Country | Micro Enterprises | Small Enterprises |
|---|---|---|
| **China** | <20 employees; ≤¥3M revenue | 20–300 employees; ≤¥20M revenue |
| **EU** | <10 employees; ≤€2M turnover/balance sheet | <50 employees; ≤€10M turnover/balance sheet |
| **Ukraine** | <10 employees; ≤€2M turnover/balance sheet | <50 employees; ≤€10M turnover/balance sheet |
| **USA** | 1–9 employees; <$250K revenue (varies) | 10–499 employees; <$41.5M revenue (varies) |
| **India** | ≤₹1 crore investment; ≤₹5 crore turnover | ≤₹10 crore investment; ≤₹50 crore turnover |
| **UK** | <10 employees; ≤£632K turnover | <50 employees; ≤£10.2M turnover |
| **Japan** | <5 employees; ≤¥10M capital | 5–50 employees; ≤¥50M capital |
| **Brazil** | ≤R$360K annual revenue | ≤R$4.8M annual revenue |
| **South Africa** | <10 employees; ≤ZAR 1M turnover | 10–50 employees; ≤ZAR 20M turnover |
| **Australia** | 1–4 employees | 5–19 employees |

Source: [author based on legislation of various countries].

Within Ukraine, the delineation of micro and small businesses adheres principally to the stipulations of the Ukrainian Law «On Accounting and Financial Reporting in Ukraine» (No. 996-XIV, as amended). This legislation aligns with the wider guidelines set by the European Union, given Ukraine’s objectives to join the EU. The system for classifying these businesses utilizes concrete, quantifiable criteria, such as employee headcount, yearly income, and total asset worth (as shown on the balance sheet). The subsequent information presents how micro and small enterprises are classified within Ukraine, incorporating the most recent modifications to the law, especially those established in 2018 and later years. These updates reflect current economic realities and alterations necessitated by the ongoing wartime situation.The classification of Micro and small enterprises in Ukraine is defined as follows. Micro enterprises are those that employ up to 10 individuals, including the entrepreneur in the case of self-employment. Their annual revenue must not surpass the equivalent of €2 million, which is roughly UAH 78 million based on recent exchange rates, although this figure is subject to adjustment according to the official exchange rate established by the National Bank of Ukraine. Additionally, the total assets, as reflected in the balance sheet, must also remain below the equivalent of €2 million. A business is classified as a micro enterprise if it satisfies a minimum of two out of the three specified criteria for the reporting year. Such entities are generally sole proprietorships, family-run businesses, or very small start-ups, frequently functioning informally or with limited formal organization [11; 174].

Small enterprises are defined as those having between 11 and 50 employees, with an annual income (revenue) not surpassing €10 million (approximately UAH 390 million, based on the official exchange rate), and total assets (as reflected in the balance sheet) also not exceeding €10 million. Like micro enterprises, a small enterprise must satisfy at least two of the three specified criteria within a given reporting year. This classification encompasses a diverse array of businesses, including small manufacturing operations, retail establishments, and service providers that exhibit moderate growth potential. The classification originates from amendments to the Law "On Accounting and Financial Reporting", which became effective in 2018. This legislation aligned Ukrainian standards with the EU Directive 2013/34/EU, categorizing enterprises into micro, small, medium, and large for the purposes of accounting and reporting [125].

Values expressed in euros are converted to Ukrainian hryvnia (UAH) using the average annual exchange rate established by the National Bank of Ukraine (NBU). For example, in 2021, the exchange rate was approximately €1 to UAH 32-33; however, this rate is subject to fluctuations due to economic instability, particularly following the escalation of the war in 2022 (in 2025, the rate is projected to be around €1 to UAH 43-44). The Ukrainian economy has seen considerable shifts since the Russianfull-scale invasionbeganin February 2022, with real-world consequences for financial metrics and asset valuations. Despite these alterations,andasweapproachearly 2025, major formal legislative changes to these financial benchmarks remain largely absent.

Instead, the government has opted for temporary solutions aimed at easing the burden of taxation and regulation; an example includes simplified tax structuresapplicable to the ongoing state of martial law. Ukraine's thresholds, while aligning with the European MSE definitions, are specifically adapted to reflect the prevailing realities of the Ukrainian economic environment. The EU defines micro enterprises as those with fewer than 10 employees and a turnover or balance sheet total of €2 million, while small enterprises are defined as having fewer than 50 employees and a turnover or balance sheet total of €10 million [151].

Within the United States, how businesses are categorized as micro or small is dictated by guidelines established by the U.S. Small Business Administration, or SBA. These categorizations typically hinge on things like how many people a business employs, the money it makes each year, and the industry within. Micro enterprises represent the smallest segment of the business landscape, frequently operated by an individual or a minimal team. Their defining characteristics include: employee count – 1–9; annual revenue – typically under $250,000. Illustrative examples: freelancers, home-based ventures, small retail establishments, and local service providers such as plumbers, electricians, or consultants. Small enterprises are marginally larger than micro enterprises and are categorized by the SBA according to specific industry standards. The classification generally encompasses the following criteria: number of employees – fewer than 500 employees for the majority of industries and fewer than 1,500 employees for certain manufacturing sectors (Manufacturing – fewer than 500–1,500 employees; wholesale trade – fewer than 100–250 employees); annual revenue – varies by industry but typically falls within the range of $1 million to $40 million (retail: to $8 million; construction: up to $39.5 million; professional services: to $16.5 million). Ownership, generally, owned and managed by private individuals. Local orientation, primarily, cater to local or regional clientele. Adaptability, possess the capacity to swiftly respond to market fluctuations. Employment generation, significant players in job creation within the U.S. economy. Innovation, frequently lead advancements in specialized markets. Small enterprises constitute 99.9% of all businesses in the United States and provide employment for 47.1% of the private sector workforce. Micro and small enterprises play a crucial role in contributing to the GDP and enhancing local economies. These enterprises encompass a diverse array of industries and demographics, including businesses owned by minorities, women, and veterans [155; 167].

In India, the micro and small business sector is officially recognised as Micro, and Small Enterprises. This designation is mandated by the MSE Development Act of 2006. A company's MSE status is gauged using investment in its production infrastructure and the revenue generated throughout the year. The Indian government revised the MSE classification parameters in 2020 to enhance both its reach and efficiency. The classification of micro enterprises within the manufacturing sector is defined by an investment in plant and machinery not exceeding ₹1 crore (approximately $120,000) and an annual turnover capped at ₹5 crores (approximately $600,000). In the service sector, micro enterprises are similarly classified with an investment in equipment also limited to ₹1 crore (approximately $120,000) and an annual turnover of up to ₹5 crores (approximately $600,000). Common examples of such enterprises include small tailoring shops, local bakeries, home-based handicraft businesses, and freelance service providers. The classification of small enterprises within the manufacturing sector is defined by an investment in plant and machinery ranging from over ₹1 crore to ₹10 crores (approximately $1.2 million), alongside an annual turnover exceeding ₹5 crores but not surpassing ₹50 crores (approximately $6 million). In the service sector, small enterprises are similarly classified based on an investment in equipment that falls between ₹1 crore and ₹10 crores (approximately $1.2 million), with an annual turnover also exceeding ₹5 crores and up to ₹50 crores (approximately $6 million). Common examples of such enterprises include small-scale manufacturing units, food processing facilities, and IT service providers with limited operational scope [152; 176].

The essential characteristics of Micro and Small Enterprises in India include their significant role in employment generation, as they are the second-largest source of employment in the country, following the agricultural sector. Additionally, MSEs contribute approximately 30% to India's Gross Domestic Product (GDP). They also play a vital role in international trade, accounting for nearly 40% of the nation's total exports. Furthermore, MSEs are instrumental in fostering balanced regional development by establishing industries in rural and semi-urban regions. Micro and small enterprises serve as a fundamental pillar of the Indian economy, promoting innovation and entrepreneurial activities. They create avenues for marginalized communities, such as women, rural residents, and economically disadvantaged groups. The relatively low capital requirement for micro and small enterprises enhances their accessibility to a broader segment of the population. Furthermore, these enterprises possess the agility to respond swiftly to shifts in market conditions and consumer preferences. Sectoral classification underscores the significant presence of micro and small enterprises in agriculture, characterized by a high level of informality, as well as in the services and industrial sectors, each requiring distinct reform approaches. The aspect of gender ownership further distinguishes MSEs, as enterprises led by women are frequently informal and operate on a micro scale, encountering specific challenges. Additionally, the geographical context, whether urban or rural, along with the potential for growth such as high-growth “gazelles” compared to survivalist firms receives less emphasis. This classification serves as a foundation for designing reforms, ensuring a balance between targeted interventions for informal MSEs and broader systemic enhancements that benefit enterprises of all sizes [154; 178].

*Impacts on Government and Economy Development.* MSEs play a crucial role in shaping government policy and driving economic development, serving both as beneficiaries and catalysts for reform. Governments, often with the assistance of donor agencies, undertake reforms in the business environment to leverage the potential of MSEs for job creation and poverty alleviation, particularly given their significant contribution to employment exceeding 70% in numerous developing nations. The objectives of these reforms include promoting economic growth and transformation by addressing barriers to MSE expansion, facilitating the formalization of informal enterprises, encouraging entrepreneurship through the support of start-ups, enhancing job quality by improving labour conditions, and advancing women’s economic empowerment by dismantling gender-related obstacles. These initiatives are in harmony with broader development objectives, such as the Sustainable Development Goals (SDGs). MSEs play a significant role in promoting inclusive economic growth by providing employment opportunities for the impoverished and marginalized populations. However, their impact on structural transformation is not as pronounced as that of larger enterprises. Reforms designed to lower business costs, mitigate risks, and eliminate competitive barriers are intended to encourage investment and innovation within MSEs, thereby indirectly contributing to GDP growth. Research conducted in Vietnam and Sri Lanka indicates that formalization can lead to increased profits and value addition, which in turn benefits national economies, although the extent of these benefits can differ based on specific contexts [110; 153].

Governments face several challenges when implementing MSE reforms, including the need for political will to address power imbalances that favour larger enterprises, capacity constraints due to limited resources for reform implementation, and a lack of data that impedes evidence-based policymaking. Successful initiatives, such as the simplification of business registration in Nigeria, supported by DFID, have resulted in annual savings for businesses, demonstrating economic benefits. There are risks associated with these reforms, particularly the potential for discouraging growth if MSEs remain reliant on benefits tied to their size, highlighting the importance of a balanced approach. Donor agencies promote optimal practices by advocating for the simplification of regulations, the enhancement of transparency, the integration of MSEs into supply chains, and the improvement of public-private dialogue (PPD) to amplify these effects. Coordinated reforms that are sensitive to gender considerations and prioritize small enterprises can harmonize governmental objectives with economic development, thereby ensuring that MSEs play a vital role in fostering sustainable and inclusive prosperity without disrupting the overall market dynamics [141].

### 1.3. The role of fiscal policy for micro and small enterprises

Micro and small-sized enterprises are essential in addressing the issue of excess labour in rural areas, fostering technological advancements, stimulating local economic growth, and ensuring the social harmony and stability of ethnic communities. Nevertheless, these enterprises frequently encounter significant challenges, including inherent weaknesses, insufficient capital, and inadequate technological assistance, which can lead to their premature failure. In light of the ongoing financial crisis, it is imperative for the government to utilize public financial resources to extend support to MSEs, enabling them to navigate through these difficulties and facilitate their comprehensive development. Fiscal policy encompasses a range of financial tools employed by the government to fulfil specific objectives related to social and economic development. It can be categorized into two primary types based on its adjustment goals: macro and micro. Macro-financial policies focus on regulating economic aggregates, aiming to achieve overall equilibrium, particularly in terms of aggregate social demand, thereby mitigating macroeconomic fluctuations. In contrast, micro-financial policy targets specific sectors, industries, or enterprises, with the intention of attaining balance or enhancing the structural advancement of the economy. To realize these objectives, macro-fiscal policy typically adheres to the principle of differentiated treatment, providing supportive measures such as financial subsidies and tax incentives to sectors or enterprises that require encouragement for growth, while imposing restrictive measures, including high taxes, on those that need to be limited. In comparison to macro fiscal policies that prioritize short-term regulation and demand management, fiscal policy aimed at micro and small enterprises fundamentally serves as a long-term supply-side management strategy [149].

Small and micro enterprises play a crucial role in driving China's economic development due to their significant numbers and diverse range of industries. These businesses typically incur lower start-up and operational costs, allowing for enhanced adaptability to market conditions. Furthermore, they operate with a flexible business model, organizing their production and operations within a localized framework rather than adhering to a systematic production chain. In terms of marketing strategies, these enterprises focus on their unique production methods and prioritize the local market. Given the limited scale of production and assets, it is often challenging for small enterprises to distribute their products across multiple cities, let alone engage in exports. Recent findings from the China MSE and China Family Finance survey indicate a rapid growth of MSEs in China. The significance of micro, small, and medium enterprises within the national economic framework is increasingly recognized, establishing them as a vital component of the economy. As these enterprises continue to expand, they have emerged as a key economic force and a substantial source of fiscal revenue in many regions across China [26].

Small and micro enterprises primarily rely on labour and necessitate a greater number of employees, thereby expanding the employment opportunities available. Attaining full employment is fundamental to ensuring social stability, and the growth of small businesses significantly contributes to this goal by enhancing job creation. Many challenges that can be addressed through mechanization in larger firms must be tackled through manual labour in small and micro enterprises. Consequently, these smaller entities require more labour for the same level of capital investment, establishing them as vital sources of employment. In terms of net capital per capita, micro and small enterprises generate considerably more jobs than their larger counterparts for equivalent capital outlays. The employment rate per unit of investment and the responsiveness of labour employment per unit of output are notably higher in micro and small enterprises compared to larger firms. This indicates that, given equal investments, micro enterprises are more effective at job creation than larger ones. In China, micro and small enterprises serve as the primary means of addressing employment challenges, including urban job creation and the surplus of rural labour. In our nation, approximately 70% of the urban workforce and 80% of the rural workforce are employed in micro and small enterprises [173].

Small and micro enterprises represent essential components within the market economy and play a crucial role in advancing reform initiatives. Primarily, these enterprises maintain a close connection with the market and consumers, with a significant concentration in dynamic industries, thereby serving as a vital microeconomic foundation. Additionally, in contrast to larger corporations, microenterprises benefit from operational simplicity, lower innovation costs, and a greater capacity for rapid institutional adaptation. Furthermore, their societal impact is relatively minor, rendering them less susceptible to macroeconomic fluctuations. Consequently, micro and small enterprises are frequently regarded as a valuable platform for experimentation and a starting point for reform efforts [36].

The government has established numerous preferential measures to support the financing of micro and small enterprises; however, the majority of these initiatives are short-term in nature. While these policies are well-targeted, they do not provide the necessary sustainability to foster long-term development. Furthermore, the existing tax incentives for MSEs primarily focus on income tax, which addresses only a limited range of aspects and consequently offers minimal motivational impact on these enterprises. Additionally, the financial assistance provided to individual businesses is often insufficient. While numerous information platforms can be established across different sectors, these platforms often lack effective interconnectivity and adequate information sharing. This situation results in a degree of redundancy, and some platforms remain closed and inaccessible to the public. Additionally, the information on certain platforms may be updated at a slow pace, which prolongs the financing process for small and micro enterprises. Consequently, some platforms may miss critical financing opportunities due to the untimeliness of the information provided. The government has the capacity to enhance support for micro and small enterprises annually; however, the focus tends to be more on larger micro and small enterprises. This is primarily because these entities find it easier to secure financial assistance compared to traditional banking institutions. Consequently, the support they receive can be viewed as merely supplementary. In contrast, for micro and small enterprises, obtaining such support is akin to the challenging task of delivering coal in winter, making it particularly difficult for these smaller entities to receive substantial aid.

Financial subsidies represent a form of financial assistance provided by the state treasury to businesses and individuals, aimed at achieving specific political, economic, and social objectives. This constitutes a category of government financial transfer expenditures designed to support micro and small enterprises in their development. The primary source of these financial subsidies is the government, while the recipients are predominantly small and micro-sized enterprises. Notable examples of such subsidies include dedicated funds for the advancement of small and micro enterprises, financial support for technological innovation and research and development, employment incentives, export assistance, and subsidies for policy-related losses. The purpose of these financial subsidies is to alleviate the operational costs faced by small and micro enterprises, to steer the allocation of social capital and influence corporate economic activities, and to foster increased employment, scientific and technological advancements, and foreign trade exports [168].

Government procurement refers to the acquisition of goods, services, or works by the state from the private sector, financed through budget allocations or debt issuance. This process plays a crucial role in the overall economic development of society. The policies governing government procurement serve as a form of indirect protection and support for businesses. By leveraging government assistance, small, medium, and micro enterprises can enhance their product sales, thereby boosting productivity, increasing market share, and fostering their growth. The government also ensures transparency in the procurement bidding process and establishes regulations that enhance the evaluation system, thereby creating a conducive environment for fair competition among small and micro enterprises [111].

Loan assistance refers to the utilization of state resources to aid micro and small enterprises in overcoming their financial challenges, primarily through the provision of loan guarantees by the government. Conversely, fiscal investment and financing involve the government aggregating various idle funds, including those from private individuals, leveraging state credit to manage these resources through designated departments to fulfil policy objectives. Subsequently, these funds are allocated to support the production, operations, and developmental fiscal activities of enterprises or institutions via direct loans, low-interest preferential loans, government credit guarantees, loan subsidies, and other forms of direct or indirect financing. A significant barrier to the establishment and growth of MSEs is the lack of capital, with financing difficulties being the most pressing issue they encounter [42; 112].

Financial investment and financing aim to enhance the availability of loans for micro and small enterprises, characterized by greater flexibility in fund utilization and reduced burdens compared to direct investment and financing, as it relies on the government's creditworthiness to secure funding. The mechanism by which fiscal and taxation policies impact small and micro enterprises is illustrated in figure 1.5. This diagram depicts the operational framework of fiscal and tax policies. It is evident that diverse tax policies can assist micro and small enterprises in multiple ways. Primarily, government procurement policy instruments are employed to guarantee that MSEs secure specific product sales, thereby reserving a portion of the market share for smaller and weaker enterprises. Tax incentives serve to alleviate the tax obligations of micro and small enterprises, leading to an increase in profits due to the reduced tax load. This surplus capital can then be allocated towards enhancing product inputs and reinvesting in the growth of MSEs [169].

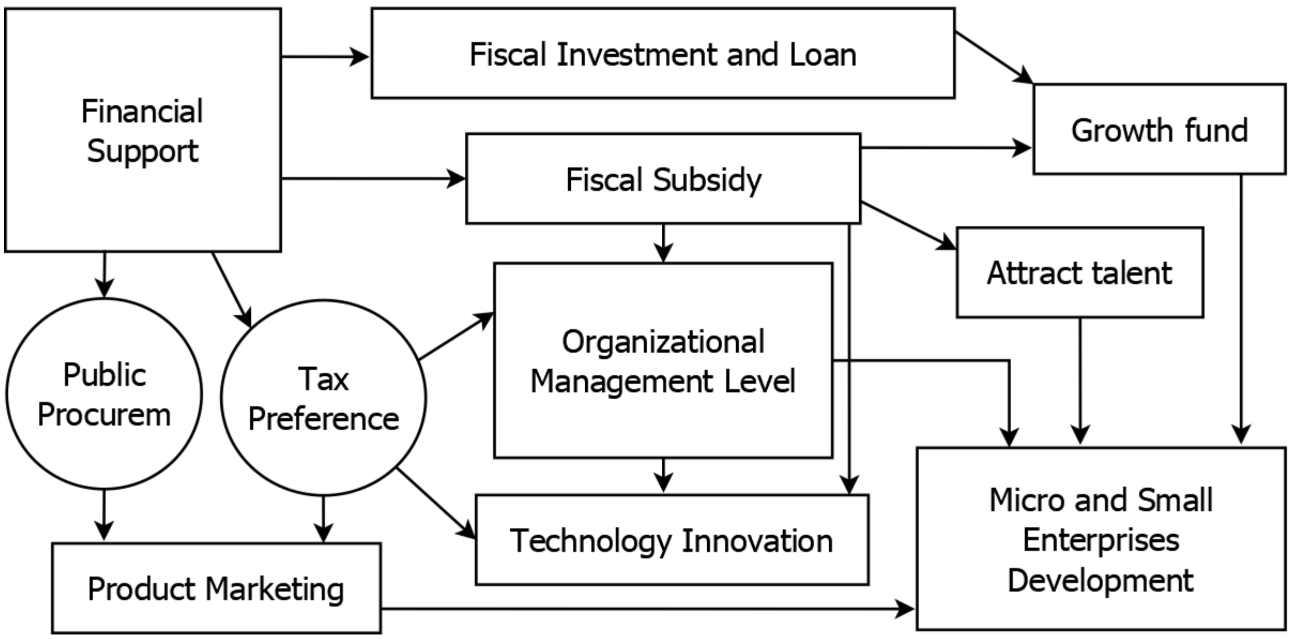


**Fig. 1.5. The mechanism of the role of fiscal policy for micro and small enterprises**

Source: [author].

Additionally, financial subsidies are employed to support small and micro-sized enterprises in various areas, including the development of scientific and technological personnel, the adoption of innovative technologies, improvements in production and operations, and restructuring efforts, all aimed at achieving significant advancements and benefits. The implementation of fiscal investment and financing policies, along with the utilization of government credit and other financial instruments, aims to consolidate various available funds directed towards small and micro enterprises. This approach seeks to address the challenges related to their development funding and loan accessibility. As previously noted, fiscal policy serves as a significant support mechanism for micro and small enterprises. It can impact their capital structure, operational status, and business models through government procurement, tax incentives, and financial grants. Furthermore, it enhances their survival and growth conditions while facilitating a restructuring of their strategic focus. For MSEs to thrive, it is essential that they receive government support and assistance, which is a critical issue for national economic development. Consequently, it is imperative for the government to take action to create a conducive environment for these enterprises, enabling them to allocate their resources effectively and manage them efficiently, thereby fostering their sustainable and orderly growth [113].

Numerous arguments are to support reforms in the business environment aimed at micro and small enterprises. Nevertheless, not all of these arguments effectively elucidate the challenges MSEs encounter within the business landscape or sufficiently outline how proposed reforms will resolve these issues. Although MSEs serve as a valuable perspective for analysing the business environment and pinpointing concerns, it is frequently essential to gain a deeper understanding of the complex web of interrelated factors that constitute the system and contribute to the difficulties faced by MSEs. The donor survey revealed a divergence among agencies regarding the value of business environment reforms aimed at addressing the issues faced by micro and small enterprises. Some agencies lack a clear justification for their support of MSEs, opting instead to evaluate each economy on a case-by-case basis. They perform assessments to pinpoint the primary drivers, challenges, and stakeholders that warrant focus, thereby establishing priorities for business environment reform. For instance, one agency promotes inclusive and sustainable industrial development through technical cooperation initiatives that encompass various themes, including the creation of shared prosperity, enhancement of economic competitiveness, and environmental protection.

The prevalent reasons for advocating business environment reform often include the creation of employment opportunities and the generation of income. However, this does not inherently suggest an exclusive emphasis on the micro and small enterprises sector. By enhancing the conditions in the industries where a significant number of impoverished individuals are employed, such reforms can lower obstacles for all businesses and foster a competitive landscape that is equitable for a greater number of firms. This perspective underscores the pivotal role that MSEs can play in driving economic growth, yet it does not lead to the conclusion that reform efforts should be limited solely to the MSE sector. Typically, business environment reform encompasses enterprises of varying sizes, with reform initiatives being supplemented by additional private sector development interventions that specifically target MSEs. Therefore, while business environment reform can be viewed as a strategy for stimulating economic demand through growth, business development initiatives are essential for enabling MSEs to compete more effectively in expanding markets [113].

Numerous agencies acknowledge that micro and small enterprises constitute the predominant segment of businesses and play a crucial role in generating employment within developing economies. As noted by business research agencies, economic development frequently initiates with MSEs, particularly in less developed nations. Many organizations contend that MSEs typically represent the majority of businesses and serve as a significant source of both formal and informal employment. Furthermore, due to the high rates of business failure and the prevalence of informality, MSEs are particularly susceptible to adverse business conditions. Consequently, reforms aimed at addressing the challenges faced by MSEs are likely to yield more immediate and tangible benefits for the economy. In his comprehensive analysis examining the effects of business environment reform on MSEs across various countries, Rocha (2012) asserts that it is justifiable to advocate for MSEs due to their significant roles in employment generation, value creation, and productivity enhancement. Although numerous interconnected factors differ from one nation to another, a robust MSE sector generally indicates a competitive and supportive business environment rather than a deficient one [111].

The World Bank (2014) contends that effective support for small and micro-sized enterprises must be grounded in a comprehensive, evidence-based understanding of the characteristics that define an MSE and the manner in which the proposed assistance will sustainably alleviate the challenges that hinder MSEs from enhancing employment, fostering growth, and creating economic opportunities in developing nations. The researches analysis reveals a lack of substantial evidence regarding the effectiveness of the most prevalent forms of targeted support for MSEs, both for the direct beneficiaries and for the broader market and economic context. Consequently, the World Bank advocates for increased clarity in the justification and design of programs aimed at smaller firms, emphasizing the need to clearly articulate the objectives of such interventions and to provide analytical justification for the support directed at MSEs. This approach should be informed by a diagnosis specific to each country and a strategic framework that outlines the sequence and combination of systemic and targeted interventions necessary to tackle the systemic challenges faced by MSEs, thereby enhancing market development and access to services [7].

It is essential to acknowledge that the size of an enterprise may not be the sole relevant factor in determining which firms should receive targeted support. For micro and small enterprises to constitute a significant category of businesses, they must be distinctly characterized from others by their unique experiences with specific policy, institutional, or market failures, as well as by the manner in which they contribute to the economy or assist the impoverished. In East Africa, fostering entrepreneurship and enhancing businesses is regarded as one of the most impactful strategies for promoting economic growth, transformation, and job creation within local communities. Certain partnerships within the private sector have been identified as concentrating on enterprise development and stimulating labour demand, which are interconnected with skills development aimed at increasing the employability of local workers [110].

The challenges that micro and small enterprises encounter in obtaining the necessary financial resources and services, such as savings options and insurance, to enhance their competitiveness and growth are extensively recorded. Consequently, MSEs frequently receive significant focus within this area of policy. White et al. (2017) examine the evidence regarding the influence of financial services on the growth and development of MSEs. Their findings indicate that while enhanced access to finance typically promotes MSE growth, the mechanisms through which this occurs are more intricate than merely addressing the high costs of finance and the stringent eligibility criteria set by commercial finance providers. Additional factors that impact this relationship include suboptimal business environments, insufficient infrastructure, corruption, and the presence of inexperienced business owners with inadequate management skills, all of which can hinder growth. Although there is evidence suggesting that stronger connections between businesses and financial institutions can facilitate access to financial services and stimulate growth, it is crucial to recognize that access to finance should not be viewed in isolation as the sole barrier to growth; rather, it should be integrated into a broader, more comprehensive strategy. Schleifer and Nakagaki (2018) illustrate that as entrepreneurs transition from micro enterprises to small and micro-sized enterprises, their financial requirements surpass what microcredit can provide, prompting them to pursue larger loans from commercial banks. To facilitate production expansion, secure new premises, hire employees, and engage in export agreements, small businesses frequently need to shift from the informal sector to the formal economy. The authors emphasize the specific challenges that women encounter, including navigating regulatory and governance obstacles, as well as facing social barriers and discrimination. These challenges encompass more than just the immediate concerns related to financial access [170].

Utilizing data from the World Bank Enterprise Surveys (WBES) encompassing 70,000 enterprises across 107 nations, Aterido et al. (2007) analyse the impact of access to finance, business regulations, corruption, and infrastructure challenges on job creation at the firm level. Their findings indicate that micro and small enterprises (MSEs) experience limited access to formal financing, incur higher bribe payments compared to larger firms, and encounter more frequent disruptions in infrastructure services. In contrast, larger firms tend to invest considerably more time navigating bureaucratic processes and engaging with officials. The authors contend that these findings highlight the necessity for substantial reforms in the business environment, particularly within the financial sector, to facilitate the growth of micro enterprises. Similarly, Martinez Peria and Singh (2014) leverage WBES data from 63 countries covering the years 2002 to 2013 to investigate the influence of credit bureaus. Their research reveals that the likelihood of a firm obtaining financing increases with the utilization of credit bureaus, accompanied by a reduction in interest rates, an extension of loan maturities, and a higher proportion of working capital financed by banks.

Beck and Cull (2016) analyse WBES data to assess the accessibility of financial services and the significance of financing constraints for businesses in Africa. Their research indicates that smaller enterprises are approximately 30 percent less likely to secure a formal loan compared to larger firms, while medium-sized enterprises are 13 to 14 percent less likely to obtain such financing. Furthermore, businesses structured as partnerships or sole proprietorships, which represent the most basic forms of organization, exhibit a lower likelihood of acquiring formal loans. In the context of Egypt, Loewe (2013) explore the determinants influencing the advancement of MSEs. They highlight that the limited presence of medium-sized enterprises stems from the difficulties these firms encounter in maintaining their status as medium or large entities. The business environment, particularly issues related to what they refer to as 'state-business interactions' including licensing, taxation, inspections, and competition regulation was identified as a significant barrier to the survival and growth of MSEs.

The challenges faced by micro and small enterprises MSEs in securing financing are widely recognized; however, the effects of development programs specifically aimed at MSEs to address these challenges remain less understood. McKenzie (2009) conducts a review of various impact evaluations related to finance and private sector development to extract valuable insights and identify existing knowledge gaps. He observes that, although these evaluations have spurred reform initiatives in sectors such as microfinance, microenterprises, insurance, and regulatory changes, there exists a limited number of rigorous studies. There is a pressing need for additional evaluations across a broader spectrum of policies and diverse institutional contexts to ascertain what strategies are effective, in which environments, and for what reasons.

Limited access to financial resources remains a significant challenge for many MSEs that are owned and managed by women. According to the World Bank, female-owned businesses (agricultural sector), encounter specific obstacles in securing financing. Typically, women-owned enterprises are smaller in scale compared to those owned by men and experience slower growth, a situation exacerbated by their restricted access to financial resources. Research by Fafchamps (2013) indicates that female micro-entrepreneurs are less likely than their male counterparts to benefit from increased cash grants, as they often face competing financial demands, particularly related to household responsibilities. When capital is increased, women business owners experience benefits comparable to those of men. De Mel (2009) found that in households where women possess greater decision-making authority and have supportive husbands, they allocate a larger portion of financial grants towards working capital, resulting in favourable returns on their investments. Furthermore, the DCED (2017) provides evidence that policies aimed at establishing dedicated credit lines for women can enhance their access to financial resources [171].

The following is a theoretical discussion regarding the role of fiscal policy in promoting the growth of micro and small enterprises, accompanied by an examination of the primary benefits and drawbacks of its impact. This discussion is grounded in economic theories and principles that are frequently associated with MSEs, offering a comprehensive viewpoint. Fiscal policy, which refers to the government's approach to taxation and spending aimed at influencing economic performance, is crucial for the advancement of micro and small enterprises. Theoretically, fiscal policy promotes the growth of MSEs through various channels, supported by economic theories including Keynesian economics, supply-side economics, and principles of public finance. According to Keynesian economics, government actions such as increasing expenditure or lowering taxes can elevate aggregate demand, thus invigorating economic activity. For micro and small enterprises, this results in improved market prospects. Fiscal policies such as tax reductions or subsidies enhance the disposable income of consumers and owners of micro and small enterprises, thereby stimulating demand for MSE products and services. Government expenditure, particularly on infrastructure initiatives, generates contracts or demand that MSEs can meet, thereby increasing their revenue and promoting growth [153].

When a government lowers VAT rates, it boosts consumer purchasing power, which encourages MSEs, such as small retailers, to ramp up production or expand their workforce. Supply-side economics focuses on minimizing production costs and encouraging investment to improve overall economic output. By implementing lower taxes or specific fiscal incentives, the profitability and competitiveness of MSEs are significantly enhanced. Tax exemptions, reduced corporate tax rates, and streamlined tax systems, such as flat-rate taxation, contribute to a decrease in operating costs for micro and small enterprises. This reduction in expenses allows for the reallocation of capital towards investments in equipment, technology, or workforce development. Additionally, subsidies, such as those aimed at offsetting energy costs, further diminish production expenses, thereby facilitating the scaling of operations or fostering innovation within MSEs. Implementing a tax holiday for micro enterprises incentivizes owners to formalize their businesses and focus on growth rather than evading taxes.

Public finance theory emphasizes the importance of efficient resource allocation, whereas formalization theory, as articulated by De Soto (2000), posits that fiscal incentives can facilitate the transition of informal micro and small enterprises into the formal economy, thereby unlocking their growth potential. Simplified tax structures and grants can alleviate the fiscal burden and diminish the perceived risks associated with formalization, thereby motivating MSEs to register. Achieving formal status enables access to government resources, such as loans and procurement contracts, which significantly enhances their capacity for growth and competitiveness. Consequently, the state’s 5% Single Tax for micro enterprises serves as an incentive for formal registration, connecting MSEs to formal credit markets and enhancing their investment capabilities. Additionally, fiscal policy functions as a stabilizing force, akin to Keynesian automatic stabilizers, helping to mitigate the adverse effects of economic downturns on vulnerable entities like MSEs [153].

In times of economic downturns or crises, such as wars, tax relief and direct subsidies offer essential liquidity to micro and small enterprises, enabling them to endure challenging conditions, while public expenditure helps to sustain consumer demand. This approach mitigates the risk of business closures and fosters recovery efforts. Following the fiscal relief measures implemented in Ukraine after the 2022 war, including tax deferrals, MSEs have been able to sustain their operations despite market disruptions. From a theoretical perspective, fiscal policy plays a crucial role in promoting the growth of MSEs by boosting demand, lowering operational costs, encouraging formal business practices, and enhancing overall resilience. It utilizes governmental authority to establish a supportive environment conducive to the success of MSEs, which aligns with broader economic objectives such as job creation and GDP enhancement [141].

Main advantages of fiscal policy impact on micro and small enterprises: *(i) Increased financial resources.* Tax incentives or subsidies can significantly improve the cash flow of MSEs, allowing them to reinvest in their operations, upgrade technology, or expand their workforce. This, in turn, enhances productivity and competitiveness. For instance, a small bakery that receives a tax reduction may utilize the savings to purchase a new oven, thereby doubling its production capacity. *(ii) Encouragement of formalization.* Streamlined tax systems or incentives can diminish the cost-benefit disparity associated with formalization, enabling MSEs to access formal markets, secure credit, and receive government assistance, which supports sustainable growth. Research (e.g., Boly, 2015) indicates that formalization can lead to increased profits for MSEs by improving their market access. *(iii) Job creation and economic inclusion.* Fiscal stimulus measures, such as payroll tax reductions, decrease the costs associated with hiring, allowing micro and small enterprises to increase their workforce. This leads to a decrease in unemployment rates and fosters inclusive economic growth, particularly benefiting marginalized groups, including women. MSEs account for over 70% of the global workforce (ILO, 2018), thereby amplifying this positive impact. *(iv) Enhanced resilience.* During times of crisis, subsidies or tax relief serve as essential support, helping to avert the collapse of MSEs and maintaining economic stability. This support is particularly vital in unstable economic environments. For instance, wartime tax relief in Ukraine has enabled micro retailers to continue operating despite challenges in the supply chain. *(v) Market expansion opportunities.* Government expenditure, such as investments in infrastructure or preferential procurement policies, generates demand that MSEs can fulfil, thereby broadening their customer base and enhancing revenue opportunities. Contracts awarded to small construction firms can stimulate growth in rural regions [162] (see fig. 1.6).

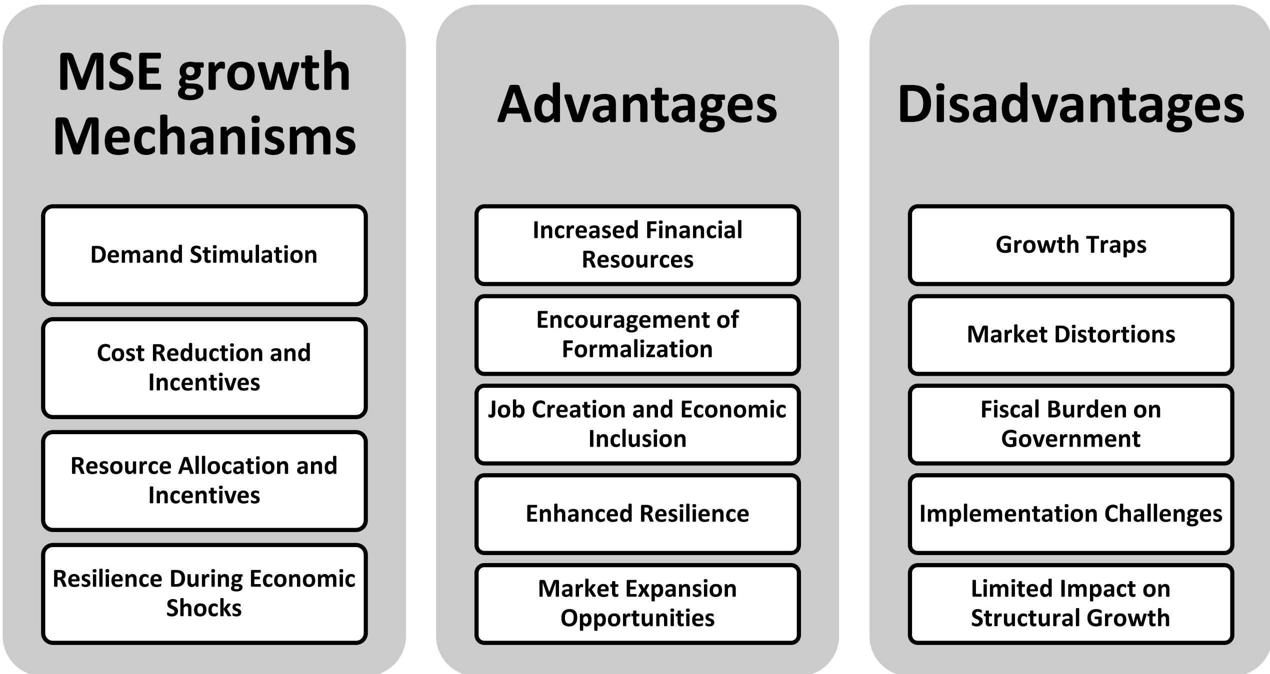


**Fig. 1.6. MSE growth mechanisms and fiscal policy stimulation**

Source: [author].

Main <u>disadvantages</u> of Fiscal Policy Impact on Micro and Small Enterprises: *(i) Growth traps.* Fiscal incentives tailored to specific sizes, such as tax exemptions for businesses with fewer than ten employees, may inadvertently hinder MSEs from expanding beyond certain limits in order to maintain these benefits, thereby impeding their scalability. Research by Reinecke and White (2004) indicated that MSEs in

Pakistan often opted to divide into smaller entities to circumvent labour regulations, which ultimately restricted their overall growth. *(ii) Market distortions.* The preferential treatment afforded to MSEs can lead to an uneven playing field in competition with larger enterprises, thereby distorting market efficiency and potentially diminishing economic vitality. Subsidized MSEs may engage in price undercutting against unsubsidized medium-sized firms, resulting in skewed market pricing. *(iii) Financial burden on government.* Generous tax incentives or subsidies can place significant pressure on public finances, potentially leading to a decrease in available resources for essential infrastructure or services that indirectly support micro and small enterprises. This trade-off is particularly pronounced in economies facing financial constraints. *(iv) Implementation challenges.* Insufficient administrative capabilities or corruption may result in the misallocation of fiscal benefits, such as providing subsidies to ineligible companies, which undermines the effectiveness of policies and erodes public trust. In developing nations, inadequate tax enforcement enables informal MSEs to evade fiscal incentives. *(v) Limited impact on structural growth.* Fiscal policies frequently focus on immediate survival rather than addressing long-term structural challenges, such as access to technology and skill development, thereby constraining the potential of MSEs to contribute to economic transformation. According to the World Bank (2014), it is medium and large enterprises that primarily drive export-led growth, rather than MSEs, despite the existence of fiscal support.

Fiscal policy plays a crucial role in fostering the development of micro and small enterprises by harmonizing demand-side and supply-side influences, thereby promoting formalization and enhancing resilience. It establishes a conducive environment that enables MSEs to navigate resource limitations and overcome market obstacles. The key advantages: financial relief, formalization, job creation, resilience, and improved market access – significantly bolster the viability of MSEs and promote economic inclusion, thereby fulfilling the redistributive and simulative objectives of fiscal policy. Nevertheless, challenges such as growth traps, market distortions, fiscal pressures, implementation shortcomings, and limited structural impact underscore the necessity for well-balanced and thoughtfully designed policies [164]. An excessive dependence on fiscal interventions, without accompanying support measures (such as training and infrastructure development), may hinder the sustainable growth of MSEs. In practice, the formulation of effective fiscal policy for MSEs necessitates targeted approaches (for example, graduated tax rates), transparency, and alignment with broader economic strategies to optimize benefits while addressing potential drawbacks. For instance, the simplified taxation system exemplifies a successful initiative in promoting formalization, yet wartime fiscal constraints highlight the importance of adaptive and sustainable strategies.

## Conclusions to chapter 1

The analysis of the macroeconomic foundations of fiscal policy reveals its evolution through various theoretical frameworks, including Keynesian, Classical, Neoclassical, Supply-Side Economics, and Modern Monetary Theory. These schools of thought highlight different approaches to government intervention in managing economic fluctuations. A key concept in contemporary fiscal policy is the role of automatic stabilizers, which are more effective in advanced economies due to stronger institutions and broader tax bases. In contrast, developing countries often face limited fiscal capacity, weakening their ability to respond effectively to economic downturns. The effectiveness of fiscal interventions depends largely on a government's fiscal space its ability to increase spending or reduce taxes without jeopardizing financial stability. In times of fiscal constraint, automatic expenditure reductions may occur, sometimes worsening economic conditions. Moreover, fiscal stimulus may be counterproductive in high-inflation or external deficit scenarios. Fiscal policy plays a critical role in influencing aggregate demand and wealth distribution, especially during periods of underperformance. However, a balance must be struck between short-term stimulus and long-term goals such as national savings and capital formation. Ultimately, fiscal policy must be adaptive to economic context, ensuring it supports recovery without undermining future growth or crowding out private investment.

Micro and small enterprises are vital contributors to employment and economic development, particularly in developing countries, where they make up the majority of businesses and provide over 70% of jobs. However, their growth and sustainability are constrained by systemic challenges, including bureaucratic inefficiencies, corruption, inadequate infrastructure, and limited access to justice and finance. Political instability and weak institutional capacity further hinder reform efforts that aim to support MSEs. To address these issues, donor and development organizations emphasize the need for comprehensive business environment reforms. These include simplifying business registration, improving tax systems, strengthening judicial access, and promoting public-private dialogue to ensure MSEs have a voice in policymaking. Theoretical perspectives vary, with the "level playing field" approach advocating equal treatment for all enterprises, while the "differentiated approach" recognizes the distinct needs of MSEs. Additionally, the formalization theory suggests that a supportive environment can encourage informal businesses to register formally, enhancing their sustainability and contribution to economic development. Ultimately, MSEs are not only beneficiaries of reform but also drivers of change. Tailored reforms that reduce costs, mitigate risks, and remove barriers can empower MSEs to innovate, invest, and play a more prominent role in national development and poverty reduction efforts.

The fiscal and financial support mechanisms aimed at micro and small enterprises (MSEs) play a critical role in enhancing their viability and economic contribution. While subsidies, tax incentives, government procurement, and loan guarantees provide essential relief and promote formalization, innovation, and job creation, they are often limited by administrative inefficiencies, fragmented information systems, and insufficient funding. These limitations reduce the timely access to crucial financial opportunities, undermining the potential benefits of such policies. Fiscal interventions offer substantial advantages, including increased financial resources, enhanced resilience during crises, expanded market access through government procurement, and incentives for business formalization. These measures help MSEs invest in growth, hire more workers, and participate more fully in the economy. However, challenges persist. Growth traps may discourage business expansion to retain fiscal advantages, and market distortions can hinder fair competition. Moreover, these policies can strain public finances and suffer from poor implementation due to corruption or weak institutions. Crucially, many fiscal measures focus on short-term survival rather than addressing structural constraints such as technology access and skill development. To maximize impact, fiscal policy must be paired with improved coordination, transparency, and strategic planning. A balanced approach that addresses both immediate needs and long-term development goals is essential to unlock the full potential of MSEs.

The main scientific results were published in the following scientific articles: 162; 163; 164; 165; 166; 167; 168; 169; 170; 171.

# CHAPTER 2
# RESEARCH THE IMPACT OF FISCAL POLICY ON MICRO AND SMALL ENTERPRISES IN CHINA

## 2.1. The impact of China's fiscal policy on real GDP growth, net government lending and its transformation under global economic crisis

In recent years, China's fiscal policy has exhibited a cautious approach. Fiscal deficits have consistently been below the anticipated levels, primarily due to revenue exceeding budgetary expectations, which has not been entirely utilized. Additionally, the overall government debt has remained relatively low and has even seen a decline. The direction of fiscal policy has been predominantly influenced by the government's medium-term strategy for fiscal consolidation, which seeks to create capacity for potential future expenditures related to contingent liabilities, including the substantial nonperforming loans within the banking sector, as well as the increasing necessity for enhanced social spending in light of an aging population. China is set to adopt a definitive fiscal policy designed to enhance countercyclical regulation, characterized by a "highly proactive" approach. This policy may lead to a substantial increase in the fiscal deficit, with total fiscal expenditures likely to be expanded further. Additionally, efforts to implement countercyclical adjustments will be intensified to provide robust support for the ongoing recovery of the economy. This approach also takes into account the importance of fiscal sustainability over the medium and long term, ensuring a prudent strategy. Specifically, initiatives may concentrate on broadening the use of special bonds within the property market to stimulate effective demand [121].

Local authorities will have the capacity to distribute funds as required for special bond initiatives focused on land reserves and the purchase of existing commercial housing intended for affordable housing, within the confines of newly established special bond quotas. The Government of China could enhance its efforts to stabilize employment and stimulate consumption by raising income levels, reinforcing the social security framework, and fostering the development of new consumption sectors. In light of the emerging circumstances and challenges present in both domestic and international contexts, there exists significant fiscal policy flexibility and a diverse array of tools at their disposal. The relationship between Real GDP growth and government net lending is intricately tied to the fiscal policy decisions undertaken by the government, representing a crucial element of macroeconomic management. This correlation is underpinned by theoretical justification (see fig.2.1).

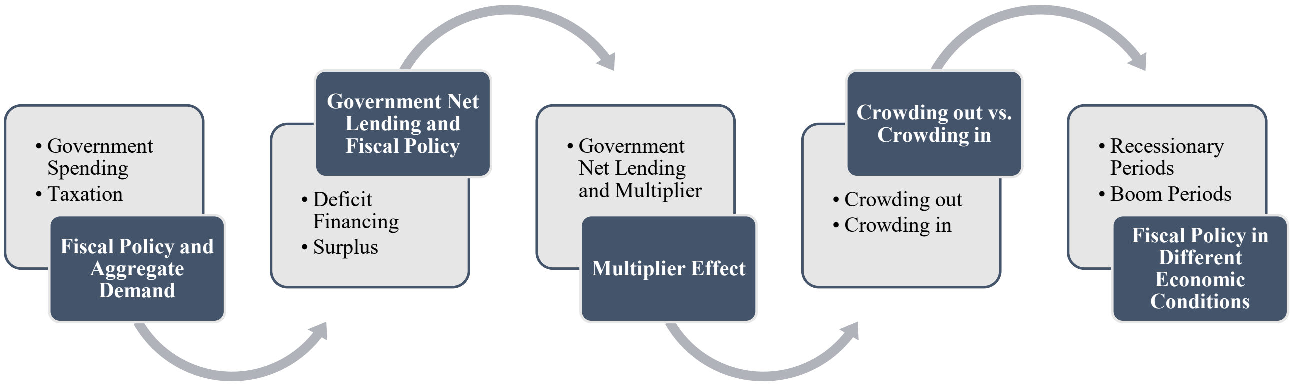


**Fig. 2.1. Fiscal policy and the relationship between Real GDP growth and government net lending**

Source: [author]

*Fiscal Policy and Aggregate Demand.* Fiscal policy, which encompasses the government's decisions regarding spending and taxation, significantly influences aggregate demand (AD) in an economy. The variations in aggregate demand are fundamental drivers of real GDP growth, rendering fiscal policy an essential tool for governments seeking to either stimulate or curtail aggregate demand. *Government expenditure* is pivotal in boosting aggregate demand by increasing the demand for goods and services. This rise in demand leads to higher output (GDP) and greater employment levels, thus fostering economic expansion. When the government invests more in sectors such as infrastructure, education, and healthcare, it revitalizes business activities and enhances consumption and investment through multiplier effects. *Tax reductions* can increase household consumption and encourage business investment, as both individuals and corporations gain more disposable income for spending or investment purposes. Conversely, tax increases reduce disposable income and dampen demand, potentially impeding GDP growth [121].

*Government Net Lending and Fiscal Policy.* Government net lending refers to the difference between the income generated by the government, mainly through taxation, and its expenditures. This metric reflects the overall fiscal health of the government and is an essential indicator of its fiscal policy stance, revealing whether the government is operating at a deficit (indicated by negative net lending), a surplus (indicated by positive net lending), or achieving a balanced budget. *Deficit Financing* occurs when a government faces a budget deficit, where its expenditures exceed its revenues. In such cases, the government often resorts to borrowing to bridge the gap. This borrowing serves as a direct stimulus to the economy, particularly when the funds are invested in productive initiatives, such as infrastructure projects. While this strategy may result in an increase in public debt, it has the potential to foster economic growth by boosting aggregate demand in the short to medium term. Conversely, a *fiscal surplus* occurs when the government's tax revenues surpass its expenditures. This scenario can lead to a reduction in overall economic demand, as decreased government spending may impede growth, particularly during periods of economic stagnation. However, fiscal surpluses can significantly contribute to reducing national debt levels, which may ultimately lessen the debt burden on the economy in the long run [164].

*Multiplier Effect.* A key mechanism through which fiscal policy impacts Real GDP growth is the multiplier effect. An increase in government spending typically leads to higher income and consumption levels for both households and businesses. This sets off a chain reaction where the initial government expenditure stimulates further rounds of economic activity, resulting in a total GDP increase that exceeds the original spending. The size of the multiplier is influenced by various factors, including prevailing economic conditions, the structure of the tax system, and the level of confidence among households and businesses. An increase in a *government's net lending through deficit spending* amplifies the *multiplier effect*. This strategy is particularly advantageous during economic recessions or periods of reduced private sector demand, as government spending can fill the void and facilitate economic recovery. The larger the amount the government borrows and invests, the more it can boost GDP in the short term [165].

*'Crowding out' vs. 'Crowding in'.* The concepts of 'crowding out' and 'crowding in' are pivotal in understanding the relationship between government net lending and economic growth. *Crowding out* refers to a situation where government borrowing leads to higher interest rates, which can displace private investment. Increased borrowing costs may deter businesses and consumers from pursuing loans for investment and consumption, thereby reducing the effectiveness of fiscal policy aimed at stimulating growth. In such instances, government borrowing can negatively affect Real GDP growth, particularly in economies with well-developed financial markets. Conversely, *crowding in* occurs when government expenditure is directed towards productive investments, such as infrastructure or research and development. This targeted spending can improve the overall business environment, reduce uncertainties for the private sector, and ultimately encourage private sector investment. In this scenario, government net lending supports rather than restricts private sector growth, contributing positively to an increase in Real GDP growth [167].

The effects of fiscal policy and the connection between government net lending and Real GDP growth can vary considerably depending on the current economic conditions. During *recessionary phases*, characterized by economic downturns, there is often a decline in private sector demand, making monetary policy inadequate for fostering economic recovery. In such scenarios, the adoption of an expansionary fiscal policy, which involves increased government spending and/or tax cuts leading to higher net lending, becomes essential for promoting Real GDP growth and stabilizing the economy. This approach allows the government to effectively inject demand into the economy, thereby alleviating the downturn in private consumption and investment. Conversely, in *boom phase* – periods of economic expansion, excessive fiscal stimulus, especially when it results in substantial deficits, can trigger overheating, inflationary pressures, and potentially unsustainable public debt. In these situations, it may be necessary to pursue a more cautious fiscal policy, which could involve achieving fiscal surpluses and reducing net lending to avert inflationary pressures that could negatively impact GDP growth [47].

In the initial three quarters of 2024, the year-on-year growth rate has slowed to 4.8%. The ongoing decline in property investment is linked to persistent challenges within the real estate sector, although the pace of this decline has eased. Meanwhile, infrastructure investment is experiencing steady growth at a moderate rate, and manufacturing investment remains robust, driven by strong export demand. Industrial production has demonstrated resilience, especially within high-tech industries. China's economic performance in 2024 reflects a return to stable growth, with a GDP increase of 5 percent, in line with government targets, as reported by the National Bureau of Statistics. For 2025, the International Monetary Fund projects a GDP growth rate of approximately 4.6 percent (see fig. 2.2).

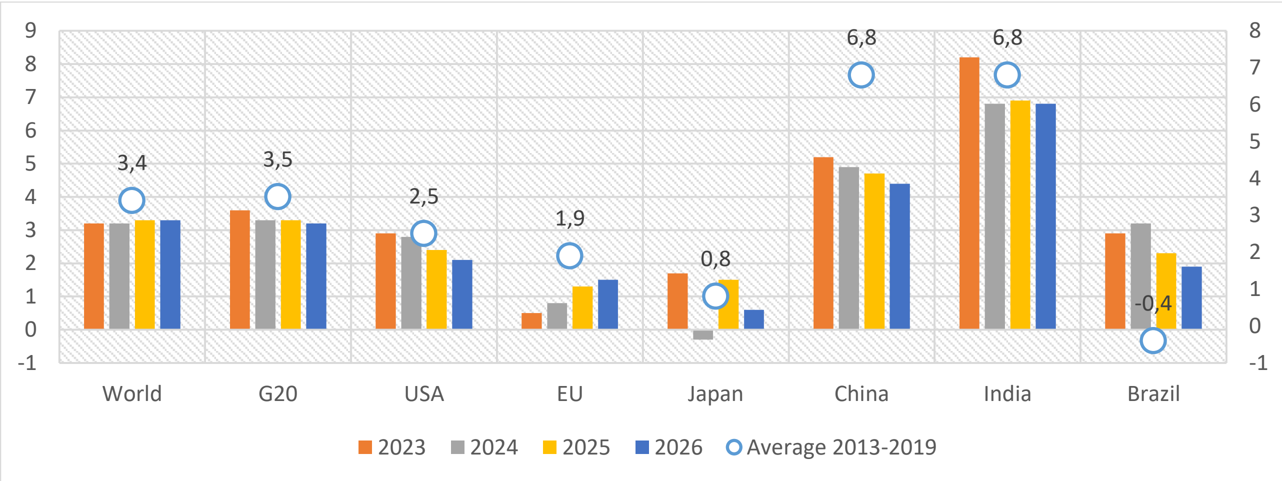


**Fig. 2.2. Real GDP growth**

Source: [8]

The outcome was notably bolstered by stimulus measures that enabled a recovery in the fourth quarter that exceeded expectations. In spite of obstacles such as a shrinking population and subdued consumer demand, positive developments were observed in key areas, particularly in industrial production and the expansion of the digital economy. Additionally, China is beginning to lessen its dependence on the property sector, with the digital economy playing an increasingly significant role in overall economic growth.

Consumption growth continues to be modest, primarily due to persistently high levels of precautionary savings. In 2024, the Consumer Price Index (CPI) inflation experienced a year-on-year rise of 0.3%, alongside reductions in prices for specific services such as transportation and telecommunications. The decline in producer prices in upstream sectors has been significantly influenced by falling input costs. Improvements in productivity, quality enhancements, and ongoing innovation play a crucial role in sustaining low prices, especially given the relatively slow recovery in consumption. Although the urban youth unemployment rate has seen a decrease, it remains high at 17.1%. The revival of external demand has stimulated Chinese exports, particularly in high-tech industries, with reduced input costs bolstering the competitiveness of these exports. While there has been a slight uptick in goods imports, a reduced reliance on imported inputs and the low import content related to consumption impede a more vigorous recovery. Furthermore, a modest rebound in tourism-related imports has limited overall import growth and contributed to an increase in the current account surplus [91].

In China, the management of Central Government (CG) debt is characterized by a cautious approach, resulting in a relatively low debt level compared to other major economies and most developing countries. In contrast, Local Governments operate under persistent deficits, which compel them to employ various strategies and exploit loopholes to achieve budgetary balance. As of the conclusion of 2023, official data reveals that China's total public debt amounts to 71 trillion RMB, accounting for 69% of GDP. This total includes CG debt of 30 trillion RMB (24% of GDP) and Local Government (LG) debt of 41 trillion RMB (32% of GDP) (see fig. 2.3). Central government (CG) debt refers to sovereign bonds issued by China’s Ministry of Finance, while local government (LG) debt includes bonds issued by provincial and municipal governments. An additional 13% of debt is linked to various government-managed funds. A major concern, however, lies in the substantial contingent liabilities at the local level, primarily stemming from debts taken on by Local Government

Financing Vehicles (LGFVs). These entities were established by local authorities to circumvent legal limits on direct borrowing. According to the International Monetary Fund (IMF), total LGFV-related liabilities surged to 60 trillion RMB in 2023—equivalent to 48% of the country's GDP—up significantly from 13% in 2014 [143].

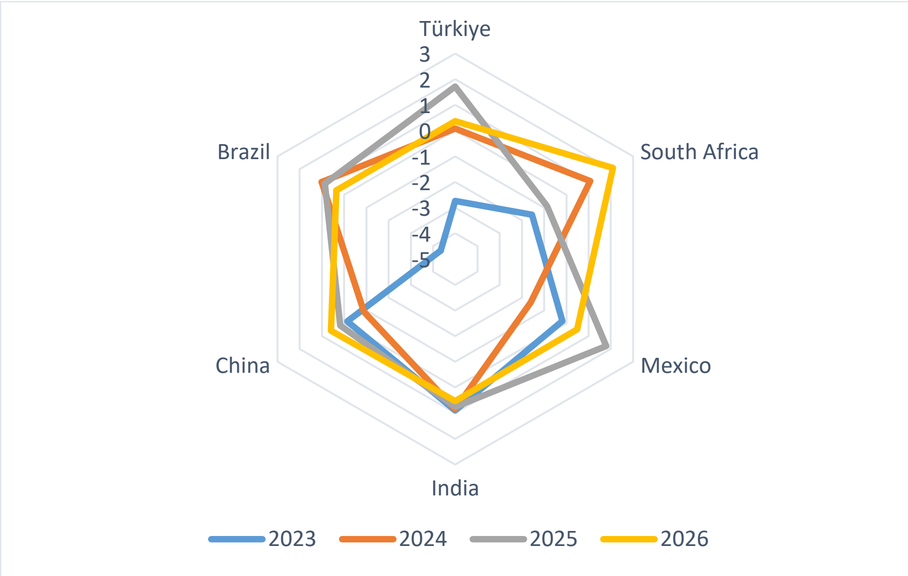


**Fig. 2.3. Government net lending, % of GDP**

Source: [5]

In 2024, monetary policy experienced significant easing aimed at promoting economic recovery and ensuring adequate liquidity in the market. This included multiple reductions in interest rates and the reserve ratio mandated for the central bank. Notably, there was a 20-basis point cut in the primary policy rate, along with a 25-basis point decrease in both the 1-year and 5-year loan prime rates (LPR) (see fig. 2.4). Furthermore, the benchmark mortgage rate was reduced, and a new framework for adjusting mortgage rates was established, allowing for lower premiums, particularly in cities where property prices are declining. Mortgage agreements with flexible rates can now be adjusted more frequently than once a year. The relaxation of prudential regulations, such as more lenient down payment requirements for secondary residences and the ability to sell mortgaged apartments, has started to encourage transactions, especially in major urban centers, first-tier cities, and resort areas. Additionally, the easing of relending quota requirements for state-owned enterprises purchasing unsold but completed properties is expected to further enhance housing demand [65].

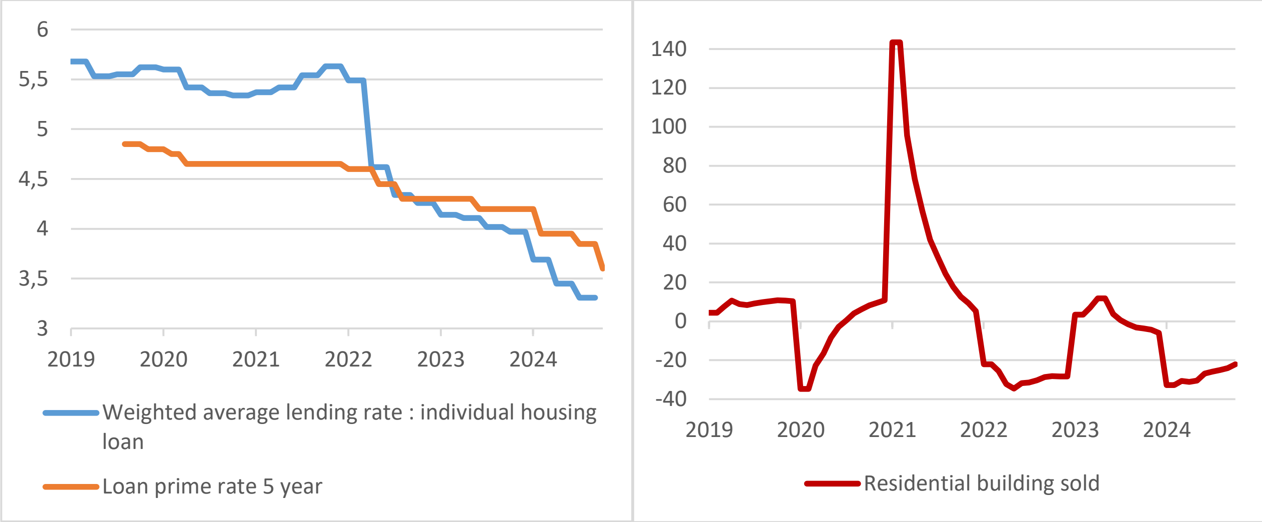


**Fig. 2.4. Dynamics of mortgage rates and housing sales in China, Y-o-y % changes**

Source: [5]

In 2024, the fiscal policy has taken on a more expansionary approach, as the central government commenced the issuance of ultra-long maturity bonds, with durations exceeding ten years, totalling 0.8% of GDP to finance essential projects. Furthermore, certain unutilized special local government bonds from 2023 are being repurposed to support initiatives in 2024, contributing around 0.4% of GDP. The quota for special local government bonds has been raised, with planned issuances totaling 1.5% of GDP in both 2025 and 2026—matching the level set for 2024. To help alleviate the debt repayment burden faced by local governments, a framework has been introduced allowing for the conversion of implicit debt—up to 3% of GDP—into formal local government debt by 2028. This measure is expected to address a significant share of the currently identified implicit liabilities. Strengthening oversight of special bond financing at the local level is essential for enhancing overall efficiency. Although recent debt restructuring initiatives have provided relief to highly indebted local governments, a persistent imbalance remains between their revenue sources and expenditure obligations. Consequently, local governments continue to encounter financial strain, exacerbated by declining real estate values. The Third Plenary Session suggests the centralization of certain vital spending responsibilities, which is a favourable development as it will guarantee a baseline of public services nationwide. Additionally, project financing will be subject to stricter monitoring, with funds allocated exclusively for approved projects. The 'cash-for-clunkers' initiative, aimed at modernizing machinery, equipment, and appliances, is expected to enhance both consumption and investment. Overall, the policy landscape is anticipated to remain supportive during the years 2025-2026 [120].

China's recent fiscal measures are designed to address medium-term structural challenges to economic growth that arise from the financial difficulties encountered by local governments. However, these initiatives are not expected to provide an immediate boost or alleviate deflationary pressures. The fiscal policies enhance the borrowing capabilities of local and regional governments (LRGs), enabling them to integrate hidden local-government financing vehicle (LGFV) debt into their financial statements. Although this will not reduce the overall leverage of LRGs, it is expected to lower total interest expenses, potentially granting LRGs greater fiscal flexibility in the medium term. China is expected to ramp up public spending in the fourth quarter of 2024, even in the absence of additional explicit fiscal stimulus measures. The risks to achieving the projected 4.8% growth rate for 2024 appear limited. Following a phase of neutral fiscal policy characterized by sluggish expenditure, the country shifted toward a more expansionary fiscal stance in the third quarter of 2024. Analysts forecast a budget deficit reaching 7.2% of GDP in 2025 [48] (see fig. 2.5).

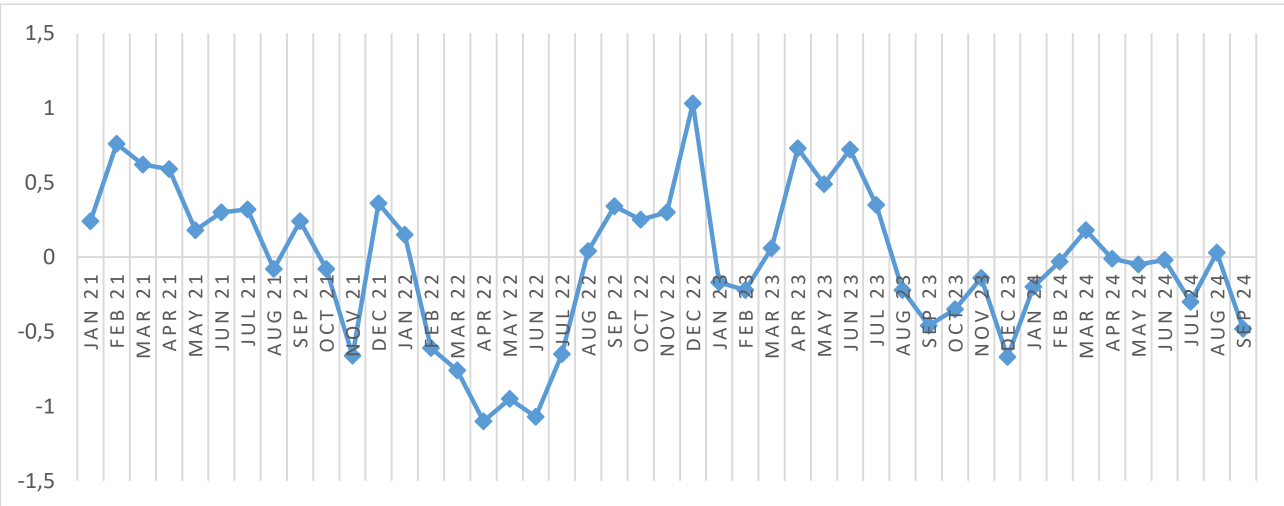


**Fig. 2.5. Month-on-month change in 12-month rolling sum fiscal deficit**

Source: [17]

In 2024, the Ministry of Finance announced the issuance of CNY6 trillion in additional special-purpose bonds (SPBs) intended for local government debt swaps over the next three years, alongside CNY4 trillion earmarked for a five-year duration. These funds will be derived from the increased annual SPB quotas allocated to local governments. China possesses the ability to widen its fiscal deficit, enhance the SPB quota, and issue a larger volume of ultra-long central government bonds. This fiscal stimulus is both incremental and responsive to potential downside risks, including the growing likelihood of intensified trade tensions with the United States, thereby establishing a support level for growth, which is anticipated to moderate to 4.5% by 2025. The fiscal deficit is projected to remain elevated in the medium term. This scenario will contribute to a rising trend in government debt and may place additional pressure on China's sovereign rating, depending on the effectiveness of fiscal and monetary policy measures in stimulating underlying demand and mitigating deflationary pressures [67].

The latest announcements provide further clarification regarding contingent liabilities associated with undisclosed Local Government Financing Vehicle debt being transferred to Local Government balance sheets. This situation is anticipated to result in an increase in total government debt over the next five years. Additionally, the authorities plan to bolster common equity for the six state-owned banks, which may also contribute to a rise in debt levels. Recent communications concerning debt swaps are expected to mitigate the medium-term refinancing difficulties encountered by Local Government Financing Vehicles and improve their financing conditions, while simultaneously reinstating debt on the balance sheets of Local Regional Governments. While substantial deleveraging could enhance the Standalone Credit Profiles of LGFVs, it is crucial to recognize that such improvements may not necessarily lead to upgrades in their credit ratings, which are often affected by external support factors. The inadequate cash flow generated by projects, which limits operators' capacity to manage associated debt, will continue to represent a significant risk for the LGFV sector. The interest obligations for Local Regional Governments related to the additional CNY2 trillion in Special Purpose Bonds (SPBs) each year account for approximately 1% of the anticipated capital revenue for 2024. This scenario will further limit the expenditure flexibility of LRGs' capital accounts, even though the debt swap is expected to reduce overall interest expenses for the public sector [118].

Supportive monetary, fiscal, and financial policies are vital for maintaining short-term demand. Allowing borrowers to repay their mortgages early without penalties and enabling them to transfer their loans between banks would lower mortgage costs and foster competition in the banking industry. In the long term, it is imperative to create a more resilient social safety net that encourages consumption and reduces the tendency to save. Unemployment insurance should be accessible to all, and pensions must guarantee at least a basic standard of living for eligible individuals. Moreover, the scope of treatments and medications covered by health insurance should be broadened to prevent health-related expenses from pushing individuals into poverty. To address labour shortages in specific sectors, it is important to better align educational curricula with the skills required by the job market. There is a significant gap in both technical and soft skills, especially in fields such as computer programming and sales and marketing. Career guidance should commence at an early age, providing comprehensive information about the potential for securing quality employment and the associated salary ranges. Given the substantial increase in the number of higher education graduates, it is crucial to adopt a more practical curriculum and enhance internship opportunities to develop the necessary skills. Additionally, the negative perception of vocational education should be tackled by improving the quality of teachers and curricula, reducing the focus on early tracking and streaming, and promoting vocational careers among young people.

Even in circumstances where fiscal resources are accessible, substantial inflationary pressures can limit the execution of expansionary fiscal policies. If the primary driver of inflation is pent-up demand, such policies could exacerbate inflationary conditions by widening the gap between aggregate supply and demand, thereby requiring careful consideration in their implementation. On the other hand, if inflation primarily stems from increasing commodity prices, there may be opportunities to implement measures designed to mitigate the impact on the most vulnerable segments of the population, especially when the overall production of goods and services in the economy is significantly below its potential [92].

Between 2000 and 2021, the trends in the percentage of total taxation and the percentage of GDP reveal a significant correlation (see fig. 2.6). Corporate tax revenues, measured as a percentage of total tax revenues and GDP, reached their highest point in 2008, followed by a decline in 2009 and 2010, a phenomenon linked to the effects of the global financial and economic crisis. While average corporate income tax (CIT) revenues began to rebound after 2010, the unweighted average across 123 jurisdictions with available data experienced a decline in 2014, 2015, and 2016. A modest recovery in the unweighted average was noted in 2017, 2018, and 2019, spurred by increases across various jurisdictions. This was followed by a slight decrease in 2020 for both metrics; however, in 2021, average CIT revenues, as a share of total tax revenues and GDP, saw an increase, approaching the levels recorded at the peak in 2008 [133].

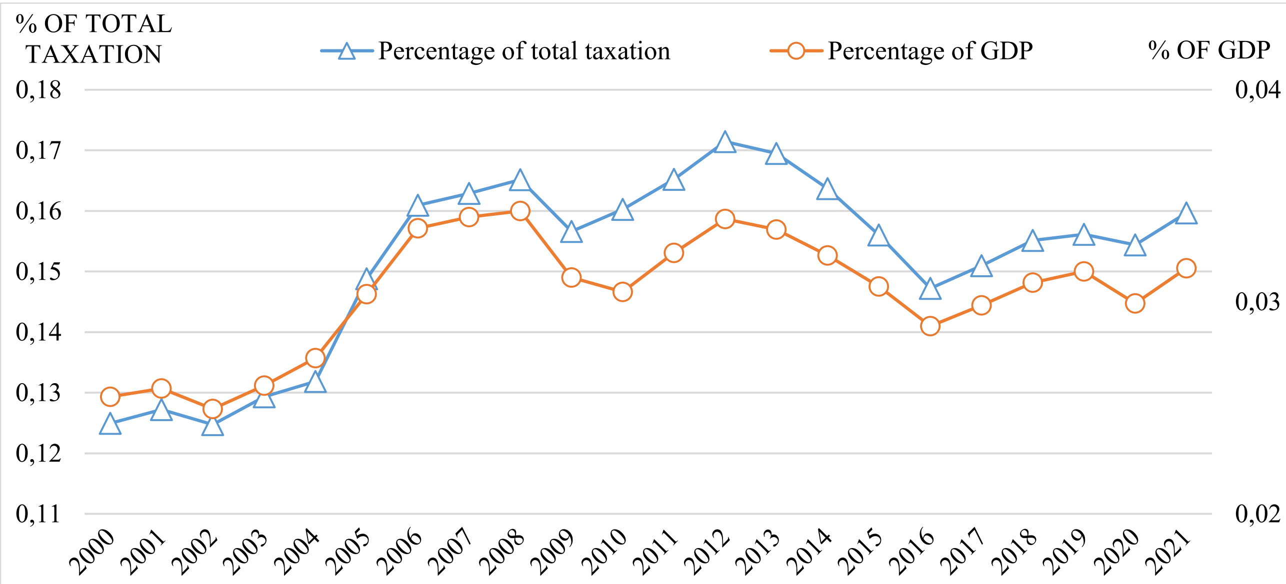


**Fig. 2.6. Average corporate tax revenues as % of total tax and as % of GDP**

Source: [93]

In 2024, industrial enterprises in China generated total profits of 7,431.05 billion yuan, representing a 3.3 percent decline compared to the previous year. State-owned enterprises reported profits of 2,139.73 billion yuan, down 4.6 percent year-on-year, while shareholding companies posted profits of 5,616.64 billion yuan, a decrease of 3.6 percent. Enterprises with foreign investment, including those from Hong Kong, Macao, and Taiwan, saw profits fall by 1.7 percent to 1,763.79 billion yuan. In contrast, private enterprises recorded a slight increase in profits, rising 0.5 percent to 2,324.58 billion yuan. By sector, the mining industry reported profits of 1,127.19 billion yuan, a 10.0 percent decline from the previous year. The manufacturing sector earned 5,514.11 billion yuan in profits, down 3.9 percent, while the electricity, heat, gas, and water production and supply sector saw profits rise by 14.5 percent to 789.76 billion yuan [17; 145].

In 2024, profit margins across key industries showed mixed performance. The production and supply of electricity and heat posted a notable year-on-year profit increase of 17.8 percent. The smelting and pressing of non-ferrous metals rose by 15.2 percent, while the extraction of petroleum and natural gas grew by 14.2 percent. Profits in the textile industry and in the manufacture of computers, communication equipment, and other electronic devices both rose by 3.4 percent. Modest gains were observed in the manufacture of special purpose machinery (up 1.1 percent) and general purpose machinery (up 0.7 percent). On the other hand, the processing of food from agricultural and sideline products declined slightly by 0.2 percent. The manufacture of electrical machinery and apparatus dropped by 2.0 percent, and the automobile manufacturing sector contracted by 8.0 percent. More pronounced declines were seen in the production of raw chemical materials and chemical products (down 8.6 percent) and in coal mining and washing (down 22.2 percent). The manufacture of non-metallic mineral products fell sharply by 45.1 percent, while the smelting and pressing of ferrous metals experienced the steepest decline, plunging 54.6 percent. Furthermore, the processing of petroleum, coal, and other fuels shifted from a profit in the previous year to a loss in 2024 [117].

In 2024, industrial enterprises recorded a total business revenue of 137.77 trillion yuan, representing a year-on-year increase of 2.1 percent (see Fig. 2.7). Business costs rose by 2.5 percent, reaching 117.31 trillion yuan. The profit margin on business revenue declined to 5.39 percent, down 0.30 percentage points from the previous year. By the end of 2024, total assets held by industrial enterprises amounted to 178.54 trillion yuan, reflecting a 4.5 percent annual increase. Total liabilities grew by 4.8 percent to 102.71 trillion yuan, while owner's equity rose by 4.2 percent to 75.83 trillion yuan. The asset-liability ratio stood at 57.5 percent, up by 0.1 percentage points year-on-year [94].

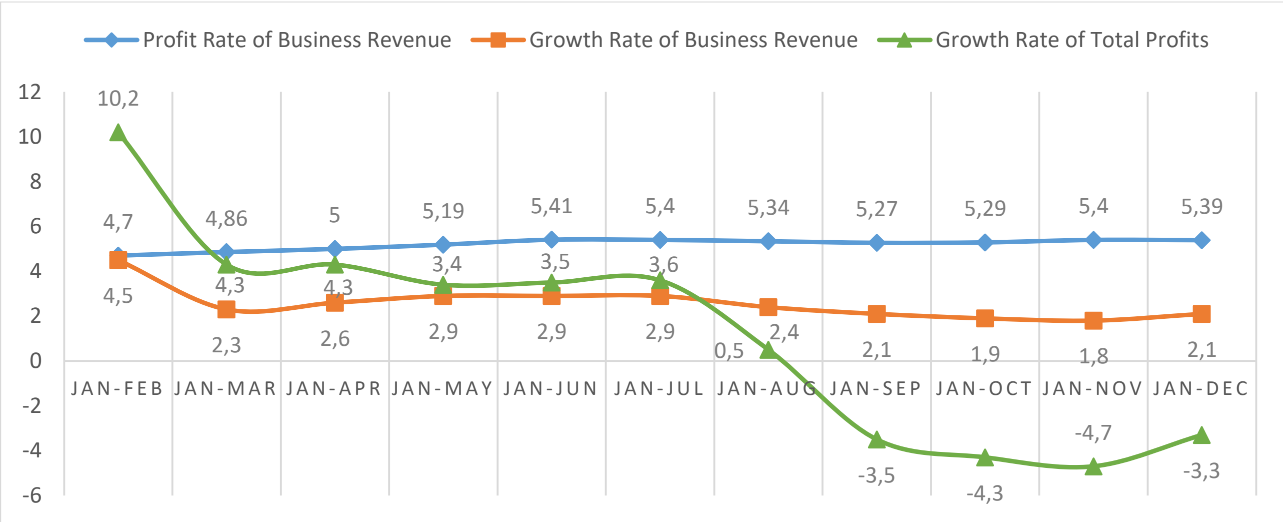


**Fig. 2.7. Monthly growth of business revenue, total profits and profit rate, China, %, 2024**

Source: [author on https://data.stats.gov.cn; 17]

By the end of 2024, industrial enterprises reported accounts receivable totaling 26.06 trillion yuan, an increase of 8.6% compared to the previous year. Inventories of finished products stood at 6.44 trillion yuan, reflecting a 3.3% year-on-year rise. The cost incurred per hundred yuan of business revenue reached 85.16 yuan, up by 0.36 yuan, while expenses per hundred yuan of revenue slightly declined by 0.01 yuan to 8.59 yuan. For industrial enterprises above the designated size, revenue generated per hundred yuan of assets amounted to 79.5 yuan, representing a year-on-year decrease of 2.7 yuan. Per capita business revenue rose to 1.861 million yuan, showing an increase of 69,000 yuan from the previous year. The turnover period for finished goods was 19.2 days, up by 0.1 day, and the average collection period for accounts receivable extended to 64.1 days, increasing by 3.9 days year-on-year [17; 95].

The current account surplus is anticipated to increase further, while inflation is expected to return to more typical, though still low, levels. Additional credit events may disrupt the orderly adjustment process within the real estate sector. Although a significant relaxation of demand-side restrictions in the property market could stimulate growth, it might also worsen existing imbalances and require a more abrupt adjustment in the future. Neglecting to address the funding gap at sub-national government levels could lead to a further build-up of implicit debt, resulting in more cost resolutions later on. Postponing essential social security reforms may perpetuate high levels of uncertainty and encourage a trend towards increased precautionary savings. An increase in global trade restrictions is likely to impede export growth and industrial activity. Nevertheless, a fiscal expansion, coupled with more stringent measures to improve spending efficiency, could enhance the impact of such spending, thereby promoting higher growth. Furthermore, a decrease in the mortgage interest burden on households may result in a slight uptick in consumption [143].

The Chinese economy is expected to undergo a gradual deceleration, primarily due to diminishing potential growth linked to unfavourable demographic trends and a slowdown in productivity enhancements. The ongoing transformations in the real estate sector are likely to persist in affecting residential investment and associated consumption areas, including furniture sales. On the other hand, infrastructure investment is anticipated to rise, bolstered by an increase in local special bond issuances. There are pressing needs related to the green transition, urban village redevelopment, and various environmental and social goals. Consumption growth is forecasted to remain steady, with minimal chances of an uptick as long as the lack of social security reforms continues to promote high levels of precautionary savings. Technological progress and competition within domestic markets are expected to uphold the competitiveness of exports, despite unit labour costs increasing at a faster rate than in other countries. Tourism imports, which represent the largest category of imports, may not recover to pre-COVID-19 pandemic levels.

### 2.2. Micro and small-sized enterprises in PRC under crisis

Micro and small sized enterprises in the People's Republic of China (PRC) are defined by the 2017 Law on "The Promotion of Small and Medium-sized Enterprises", which characterizes them as organizations with relatively modest scales in terms of workforce and business activities. The criteria for classifying these enterprises are determined by relevant agencies of the State Council. The categorization into micro, small, and medium-sized enterprises is influenced by several factors, including the specific industry, operational revenue, total assets, and number of employees. On April 23, 2021, the Ministry of Industry and Information Technology of the PRC, in conjunction with the National Bureau of Statistics and other relevant departments, undertook a review of the classification criteria for MSEs. This initiative led to the development of a revised draft for public consultation. The new draft reassesses the classification standards for enterprises that, despite having a small workforce, generate significant business income or possess considerable total assets, which were previously classified as MSEs. Additionally, it simplifies the industry classification of MSEs, reducing the number of categories from 16 to 9. MSEs play a vital role in the business landscape of the PRC and are essential to the country's economic development. They account for approximately 50% of national tax revenue and contribute 60% to the PRC's GDP. Moreover, these small enterprises are responsible for 70% of technological innovation and represent 80% of urban employment in the nation [17].

In the People's Republic of China, the categorization of businesses into micro, small, and medium-sized enterprises is determined by various factors, such as the industry sector, operating income, total assets, and the number of employees. Conversely, the European Union primarily classifies MSEs based on employee count and specific financial criteria, which may encompass either turnover or total balance sheet value. According to the European Commission, an MSE is defined as a business entity that employs fewer than 250 individuals and has an annual turnover not exceeding EUR 50 million, or total assets amounting to EUR 43 million. Additionally, businesses with significant additional resources may be ineligible for MSE classification. MSEs play a vital role in the economy of the European Union, similar to their counterparts in the People's Republic of China. Within the non-financial business sector, MSEs account for 99.8 percent of all enterprises, contribute to 65 percent of total employment, and generate 53 percent of the overall value added. The predominant category among these MSEs is micro-enterprises, which are characterized as businesses employing fewer than ten individuals and having an annual turnover that does not exceed two million euros [96].

Access to financing poses a considerable challenge for small and micro-sized enterprises, particularly in the PRC, where domestic banks often prefer to lend to state-owned enterprises (SOEs) due to perceived security. Over the years, various national policies have been introduced to address the financial obstacles encountered by MSEs. The government, at multiple levels, facilitates public financing for MSEs as mandated by the MSE Promotion Law. This funding is directed through the establishment of specialized funds aimed at supporting the growth of micro and small enterprises. Moreover, this comprehensive strategy for MSE financing is detailed in documents such as "The Five-Year Action Plan for Promoting the International Development of MSEs" and "The PRC Manufacturing 2025 Initiative". Additionally, public financing may be specifically allocated to MSEs that operate within certain sectors or engage in particular activities, including those that emphasize innovation [134].

Private financing poses significant challenges for MSEs in the PRC, primarily due to their classification as high-risk and low-return investment opportunities. The Chinese government acknowledges this issue. Article 18 of the "SME Promotion Law" emphasizes the need for direct financing by promoting the creation of a multi-tiered capital market system and enhancing equity and bond financing as potential funding sources for MSEs. These enterprises can access such financing options through the "National Equities Exchange and Quotation" (NEEQ), also known as the "New Third Board". In recent years, new platforms designed to support MSE listings have been introduced, including the "Shanghai Science and Technology Innovation Board" (STAR), which was established in 2019 and is modelled after the Nasdaq, specifically targeting innovative start-ups. To further support MSE financing, the Ministry of Industry and Information Technology (MIIT), in collaboration with 16 other governmental bodies, issued the Several Opinions on Improving the "System for Supporting the Development of Small and Medium Enterprises" (2020 Opinions) in July 2020. This document presents a range of strategies aimed at enhancing direct financing, such as initiatives to assist angel investors, private equity, and venture capitalists in increasing equity financing for MSEs; encouraging MSE listings on capital markets through mergers, acquisitions, and restructuring; diversifying bond options available for MSEs; and advancing reforms of the New Third Board, as well as facilitating the transition of companies listed on the NEEQ to other boards [144].

The MSE Promotion Law supports indirect financing by allowing the use of transferable assets and accounts receivable as collateral for chattel secured financing. Furthermore, it encourages the issuance of credit guarantees. In April 2021, the China Banking and Insurance Regulatory Commission (CBIRC) issued a circular designed to improve the quality of financial services available to MSEs. These circular outlines several initiatives, including a directive for the five largest banks to increase the share of inclusive loans extended to micro- and small enterprises by more than 30 percent, enhancing services for first-time borrowers, and fostering collaboration between the banking and insurance sectors to develop innovative financial products specifically for MSEs [96].

The issue of obtaining financing for micro-, small-, and medium-sized enterprises has been a longstanding challenge in the Chinese economy. The economic disruptions resulting from the COVID-19 pandemic have exacerbated both the importance and urgency of this issue. Following the pandemic, revenues for Chinese MSEs have fallen to less than 50% of what they were during the same period the previous year, with over 80% of these businesses facing cash flow problems. Despite the introduction of various financial support initiatives, small and medium-sized banks are struggling with rising non-performing loan ratios and shrinking net interest margins when extending credit to small and micro enterprises. This current landscape offers a distinctive opportunity to utilize big data, artificial intelligence, and other technological innovations to tackle the financing difficulties faced by MSEs [80].

The analysis presented in fig. 2.8 reveals that the hidden debt of local governments totals RMB 14.3 trillion. In light of this issue, a thorough debt restructuring plan has been suggested. This plan entails a one-time elevation of the debt ceiling by RMB 6 trillion, with RMB 4 trillion designated for the budgets spanning from 2024 to 2028, while RMB 2 trillion is postponed to a timeframe beyond 2029. As a result, local governments are left with only RMB 2.3 trillion to manage on their own.

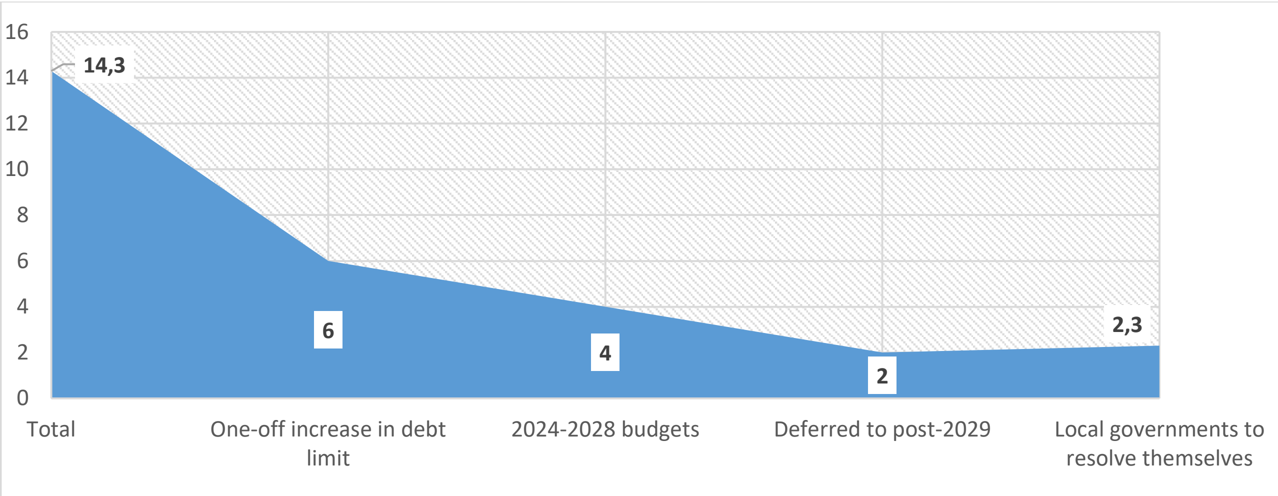


**Fig. 2.8. Local governments hidden debt, RMB trillions**

Source: [Asia Investment Strategy Team].

Some investors have raised questions regarding whether debt restructuring involves more than just a series of significant accounting modifications. It is crucial to understand that not all types of debt are the same. Off-balance-sheet debt is similar to private sector debt in that it ultimately requires full repayment. Conversely, sovereign debt is generally amenable to refinancing. The benefits of extending the maturity of debt and realizing savings on interest expenses are significant. In the past, local governments encountered difficulties in fulfilling maturing debt obligations, leading to salary cuts for public employees, delayed payments to corporate suppliers, and rigorous tax collection measures. These circumstances severely eroded business confidence. The restructuring process effectively addresses these challenges. As part of the upcoming 2025 budget, an increase in local government bond issuance quotas is expected, which will promote higher levels of investment spending. This debt restructuring serves as a preliminary step to combat deflation and allows local governments to play a more substantial role in counter-cyclical fiscal policies [97].

Fig. 2.9 shows the quarterly contributions of consumption, investment, and net exports to the GDP growth of the People's Republic of China from 2015 to 2024. Historically, consumption has played a crucial role, representing approximately 60-70% of growth between 2015 and 2022. Investment is identified as the second most significant contributor, accounting for roughly 40% during the period from 2015 to 2020. It is noteworthy that in June 2020, there was a marked increase in the investment share of GDP growth, which coincided with a substantial drop in consumption, falling from around 50%-68% in that same month.

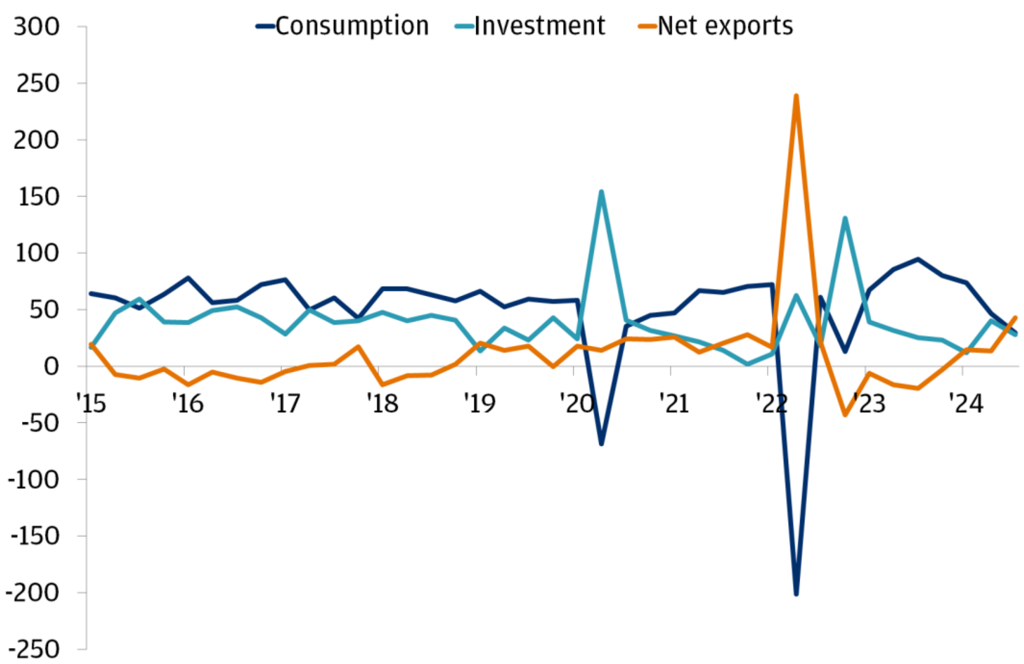


**Fig. 2.9. Share of PRC's GDP growth, quarterly %**

Source: [17].

Between 2020 and 2022, the share of GDP growth attributed to investment experienced a consistent decline, decreasing from 40.5% in September 2020 to 17% by March 2022. Regarding net exports, their contribution to GDP growth was largely negative from 2015 to 2019. However, from 2019 to 2022, this contribution turned positive, fluctuating between 10% and 20%, before witnessing a significant surge to

239.0% in June 2022. Following the onset of COVID-19 in early 2022, net exports fell sharply from this peak, reaching -43% by December 2022. Subsequently, from early December 2022 until the end of September 2024, net exports recovered to 43%. In contrast, consumption declined to 29.0% in September 2024 after reaching a peak of 94.4% in September 2023. Similarly, the investment's share of GDP growth also diminished, dropping from of 130.5% in December 2022 to 28% by September 2024.

The People's Republic of China has established an objective to cultivate one million innovative MSEs by the year 2025, as detailed in a governmental directive regarding the advancement of MSEs during the "14th Five-Year Plan" (2021-2025). By this deadline, the country aims to develop 100,000 MSEs distinguished by their uniqueness, specialization, innovation, and sophistication, in addition to 10,000 "little giant" firms, which are emerging small enterprises focused on cutting-edge technologies. It is projected that research and development expenditures for small industrial firms exceeding a specified size will maintain an annual growth rate of over 10 percent by 2025, accompanied by a similar 10% annual rise in patent applications. Initiatives throughout the "14th Five-Year Plan" period will prioritize addressing the financial difficulties encountered by MSEs, with a focus on supporting new business models, coordinating research and production, and enhancing innovation connections between large enterprises and MSEs. Furthermore, efforts will be made to improve service efficiency for MSEs and to upgrade these services through the incorporation of digital technologies [17].

In 2022, the rejection rate for loan applications from micro, small and micro-sized enterprises remained stable at approximately 3.6%. At the same time, the bank loan utilization rate among MSEs held strong at 87.7%. Overall, 58.4% of MSEs aimed to obtain a bank loan. The total outstanding business loans for micro- and small enterprises reached CNY 60 trillion in 2022, marking a 20% increase from 2021. The share of these loans has remained relatively steady over the past two years, with 47% in 2021 and increasing to 49% in 2022. Furthermore, the ratio of short-term loans to total loans for MSEs grew from 41% to 42% between 2020 and 2021, and further to 43% in 2022, indicating an increase of 0.9 percentage points [17] (see fig. 2.10).

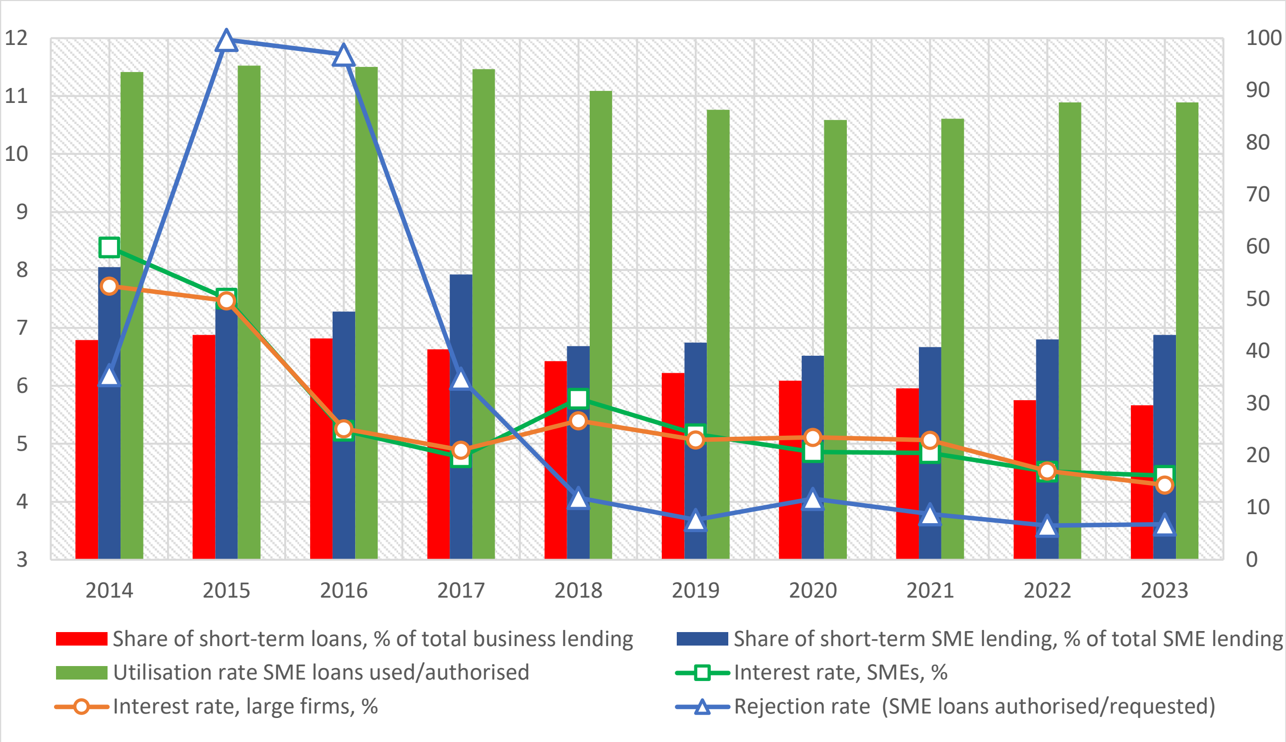


**Fig. 2.10. Financing MSEs and Entrepreneurs indexes in PRC**

Source: [144; OECD, – Financing MSEs and Entrepreneurs of PRC].

In 2022, the interest rates for MSEs and large corporations were noted at 4.45% and 4.29%, respectively, indicating decreases of 0.07 and 0.24 percentage points compared to 2021. The interest rate gap between larger firms and MSEs remained positive, rising from -0.01% to 0.16% during the period from 2021 to 2022, following an increase from -0.22% to -0.01% in the previous year. In recent years, the PRC has made significant progress in developing and implementing policies designed to lower taxes and fees related to debt financing. In 2022, MSEs faced an average of 1.42% in additional loan fees in relation to the total amount of bank loans, reflecting a slight decrease of 0.39 percentage points from the previous year. In 2022, one-year interest rates in the shadow banking sector ranged between 11.78% and 13.11%, representing a spread of approximately 7.3 to 8.7 percentage points above traditional bank lending rates. Total assets within the shadow banking system fell to 50.3 trillion yuan, marking a notable decline of 3.29 trillion yuan. Additionally, the ratio of shadow banking assets to GDP dropped to 41.6% the lowest level observed since 2013 [145].

In the past 15 years, Chinese officials have grappled with the dual challenge of promoting economic growth while simultaneously mitigating the risks of financial instability. These goals are fundamentally conflicting, as the measures taken to encourage growth frequently involve heightened borrowing, which increases the risk of a debt crisis. To invigorate the economy, the government has ramped up investment spending; however, there are occasions when this stimulus is limited due to apprehensions about the overall debt levels in the economy. The rising debt in China has intensified concerns among officials regarding financial stability. By the end of 2023, private sector debt in China had nearly doubled, reaching 200 percent of GDP. A notable outcome of this trend has been the growing focus on state-owned enterprises, often at the expense of the private sector. This shift became particularly pronounced in 2021, characterized by a campaign aimed at restraining the 'uncontrolled expansion of capital' [17; 121].

China is poised to strengthen its support for innovative micro, small and micro-sized enterprises and unicorn companies, with the objective of fostering new high-quality productive forces. This initiative aims to assist these businesses in expanding their market presence and realizing their growth potential. To improve liquidity and regulatory flexibility for MSEs, the banking sector has introduced several measures. The Central Bank of the People's Republic of China has lowered the targeted reserve requirement ratios by one percentage point, thereby releasing approximately RMB 400 billion (around US$ 57 billion) in long-term funding. Furthermore, there has been an enhancement in the flexibility of regulatory standards within the banking sector. To improve financing access for MSEs, authorities have established a specific credit quota that provides preferential interest rates. In total, RMB 1.6 trillion (approximately US$ 226 billion) has been allocated for MSEs, with half of this amount earmarked for new loans and the other half for addressing deferred loan repayments. It is important to note that these deferred repayments did not negatively affect the credit histories of the businesses involved [145].

In January 2025, both the national producer prices for industrial products and the purchasing prices for industrial producers declined by 2.3% year-on-year, maintaining the same rate of decrease as in the previous month. Additionally, when comparing month-on-month figures, both indices experienced a reduction of 0.2 percent. In January, the producer prices for industrial products experienced a decline, with prices for means of production falling by 2.6 percent. This reduction contributed to an overall decrease in the producer prices for industrial products by roughly 1.95 percentage points. Specifically, the mining and quarrying sector saw a price reduction of 4.9 percent, the raw materials sector experienced a decline of 1.9 percent, and the processing industry faced a decrease of 2.7 percent. Additionally, consumer goods prices fell by 1.2 percent, leading to an overall drop in the producer prices for industrial products by approximately 0.31 percentage points. The prices for various categories exhibited notable changes. Specifically, the cost of food decreased by 1.4 percent, clothing by 0.1 percent, while articles for daily use saw an increase of 0.5 percent [47] (see fig. 2.11).

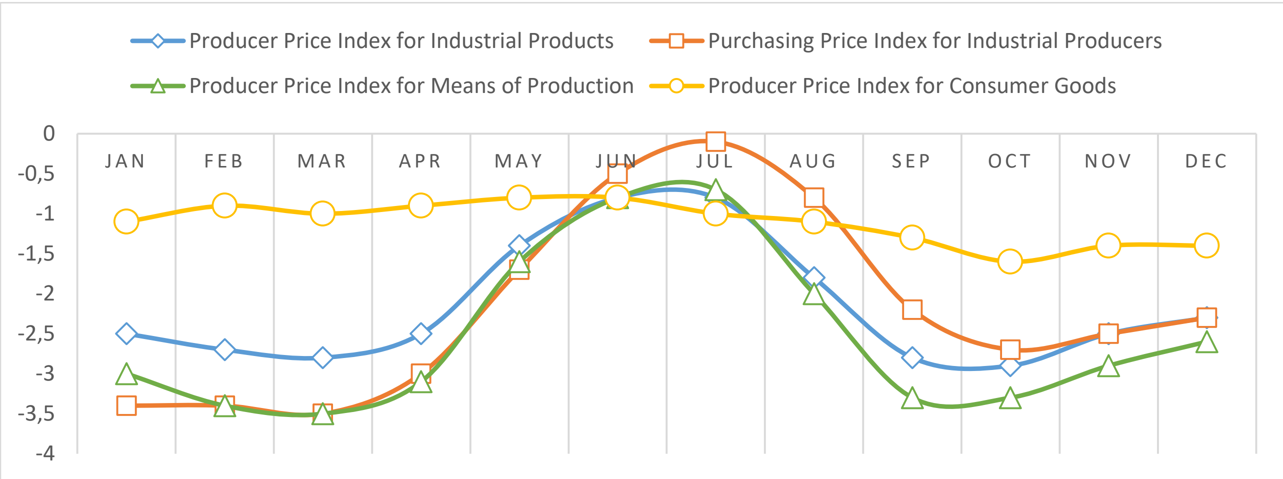


**Fig. 2.11. Producer Price Index and Purchasing Price Index, China, %, 2024**

Source: [author on https://data.stats.gov.cn]

Additionally, the price of durable consumer goods declined by 2.6%. Notable decreases were also recorded in industrial producer prices. Prices for ferrous metals fell by 8.9%, fuel and power by 5.2%, raw chemical materials by 4.1%, agricultural products by 3.3%, building materials and non-metal products by 2.3%, and textile materials by 1.4%. Conversely, prices for nonferrous metals and cables experienced an increase of 10.9 percent. The prices for various categories exhibited notable changes. Specifically, the cost of food decreased by 1.4 percent, clothing by 0.1 percent, while articles for daily use saw an increase of 0.5 percent. Additionally, the price of durable consumer goods fell by 2.6 percent. In the realm of industrial producer prices, there were significant declines as well. Prices for ferrous metals dropped by 8.9 percent, fuel and power by 5.2 percent, raw chemical materials by 4.1 percent, agricultural products by 3.3 percent, building materials and non-metals by 2.3 percent, and textile materials by 1.4 percent. Conversely, prices for nonferrous metals and cables experienced an increase of 10.9 percent. The purchasing prices for industrial producers have shown a decline, with agricultural product prices falling by 0.4 percent. Prices for ferrous metals decreased by 0.3 percent, while both raw chemical materials and textile materials experienced a reduction of 0.2 percent. Additionally, prices for fuel and power, nonferrous metals and cables, as well as building materials and non-metals, all saw a decrease of 0.1 percent [120].

By the conclusion of May 2024, the number of private business entities in China reached 180.45 million, representing 96.4 percent of the nation’s total business entities, as reported by the State Administration for Market Regulation. This figure marks an increase from the 95.5 percent recorded in 2019. The administration further noted that China is now home to nearly 55.18 million private companies and over 125.27 million self-employed individuals. The private sector has been instrumental in advancing China's high-tech and emerging industries. In the manufacturing domain, private enterprises currently constitute 96.1 percent of all manufacturing companies in the country, an increase from 95.9 percent in 2019. Additionally, the proportion of private businesses within the scientific research and technical services sector has grown from 91.9 percent in 2019 to 94.4 percent today. China has consistently advocated for the growth of its private sector, striving to establish a market-oriented, law-based, and internationally competitive business environment. Earlier this year, the country announced the initiation of a draft law aimed at promoting its private economy [133].

By the end of the previous year, China had registered a total of 124 million individually owned enterprises, which constituted 67.4 percent of all business entities in the country (see fig. 2.12). These enterprises employed nearly 300 million individuals. In 2023, approximately 22.58 million new businesses were registered, reflecting an annual growth rate of 11.4 percent. The consistent growth of individually owned businesses has contributed to the vibrancy of urban life and supported the livelihoods of countless families, showcasing the robust vitality and resilience of the Chinese economy [17].

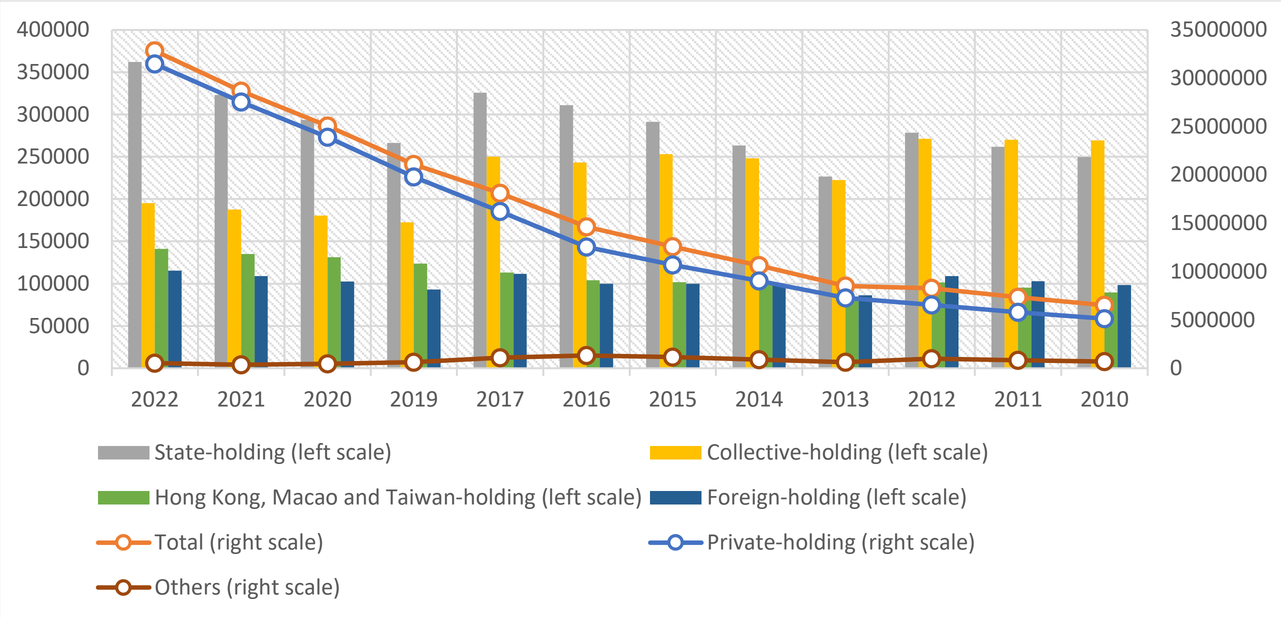


**Fig. 2.12. Number of Corporate Enterprises, China, units**

Source: [author on 17; https://data.stats.gov.cn]

The total count of private business entities in China has reached around 1.81 trillion, representing 96.37 percent of the nation’s overall business entities and indicating an increase of more than four times over the last ten years. As per the information provided by the State Administration for Market Regulation, there are currently approximately 55.54 million private companies and more than 1.25 trillion self-employed small businesses in the country. A significant number of these private entities are engaged in the services sector, which includes areas such as hospitality and catering, residential and maintenance services, wholesale and retail, as well as transport and warehousing. The wholesale and retail sectors function as a crucial link between manufacturers and a large consumer base, with the substantial involvement of private enterprises underscoring the robustness of China's market economy. The logistics industry has experienced remarkable growth, largely due to the government's supportive policies aimed at new infrastructure initiatives, intelligent transportation, and effective logistics management. China has been proactive in fostering the development of the private sector and will persist in its efforts to establish a business environment that is both market-oriented and governed by law [98].

In 2023, the typical annual salary for a construction worker in urban China reached approximately 85,800 yuan, an increase from 78,300 yuan in the preceding year. The highest average incomes are found in sectors such as information technology, research, and financial services. In 2022, the average annual salary for individuals working in urban private enterprises across the country was 65,237 yuan. This figure represents an increase of 2,353 yuan compared to the previous year, reflecting a nominal growth of 3.7%. When accounting for inflation, the real annual average wage for those employed in urban private units experienced a 1.7% increase in 2022. In 2023, the average annual salary for an employee in the urban areas of Jiangsu province, China, was approximately 125,100 yuan. In comparison, the national average salary for that year was around 120,700 yuan. Beyond regional variations, the specific industry significantly impacted the average salaries of urban employees in China. For instance, individuals working in the IT sector earned an average of about 231,800 yuan, while those in the hotel and catering industry had an average annual salary of approximately 58,100 yuan [17; 99].

A labour wage statistics survey conducted by the National Bureau of Statistics, which included data from 1,539,000 online direct reporting enterprises and 715,000 sampled units, revealed that the average annual wage for employees in urban non-private units in 2023 was 120,698 yuan (see fig. 2.13). This figure represents a 5.8% increase from 2022, although the growth rate is 0.9 percentage points lower than that of the previous year. In contrast, the average annual wage for employees in urban private units was 68,340 yuan, reflecting a 4.8% rise from the prior year, with a growth rate that is 1.1 percentage points higher than the previous year. When adjusting for price factors, the real average wage for employees in these two categories increased by

5.5% and 4.5%, respectively, surpassing the previous year's increases of 0.9 and 2.8 percentage points. It is important to note that wages encompass all forms of labour remuneration, which includes not only the wages, bonuses, and allowances received by employees but also personal income tax, social insurance contributions, and housing provident funds deducted by the employer from the employees' wages [100].

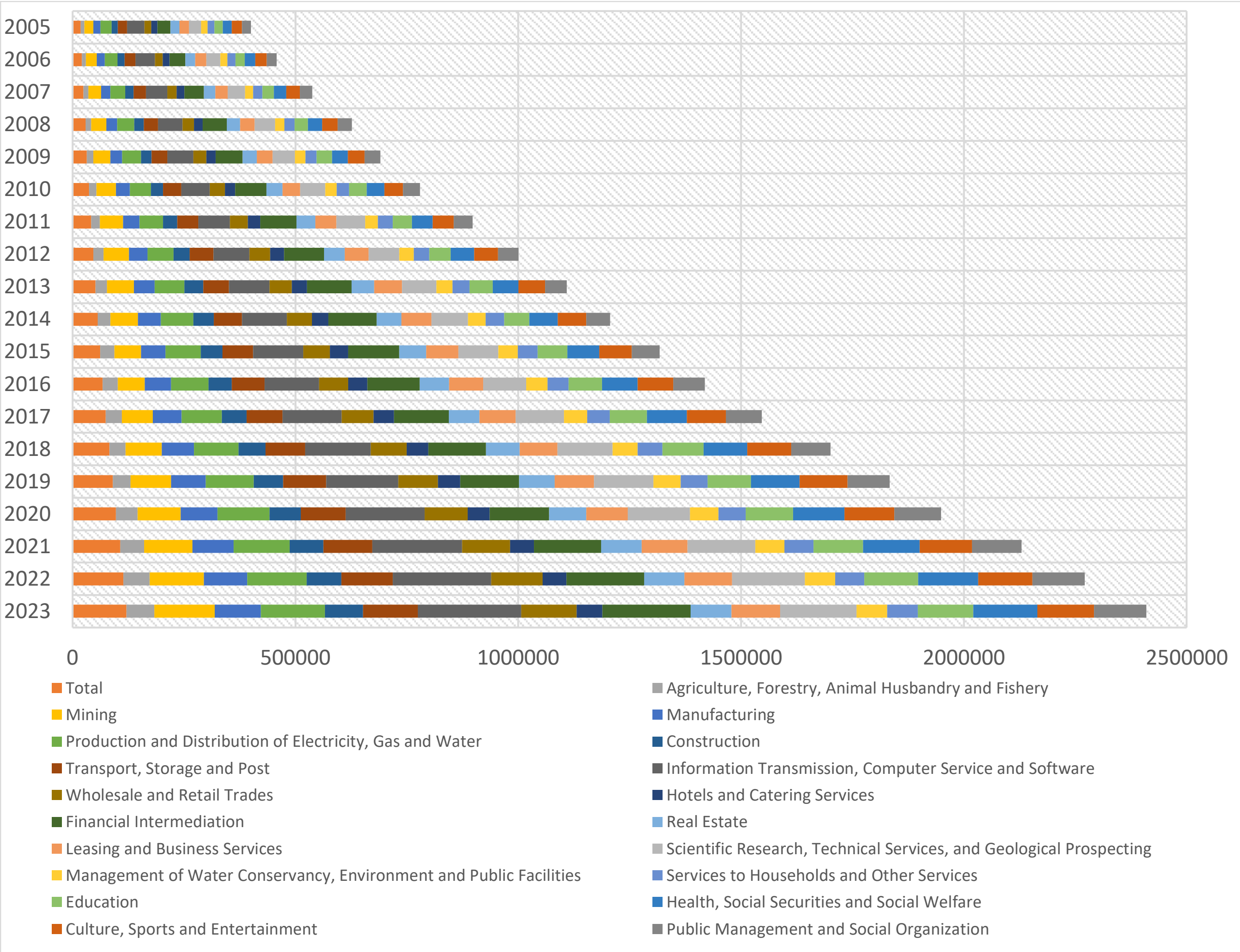


**Fig. 2.13. Average Wage of Employed Persons in Urban Units, China, yuan**

Source: [author on 17; https://data.stats.gov.cn]

Salary expectations vary due to numerous factors, with experience level being crucial; however, supplementary skills such as the capability to develop a channel sales pipeline or knowledge of global security also play a significant role. Compensation packages generally include a base salary along with various benefits. The potential for bonuses and overtime pay can greatly enhance overall income, which is advantageous.

Career progression frequently depends on changing employers, as each new role typically provides both a salary increase and opportunities for advancement.

Various factors influence wage levels in China. Key determinants include economic growth, educational attainment, skill proficiency, and industry demand. The swift economic expansion in China has notably raised average salary levels. As the GDP rises, companies grow, leading to a heightened demand for labour and corresponding wage increases. Major cities with robust economies, such as Shanghai and Beijing, typically offer higher salaries compared to less developed regions. A worker's level of education and skill set significantly impacts their potential earnings. Individuals possessing advanced degrees and specialized expertise typically receive higher salaries. In China, salary levels differ considerably among various industries, influenced by market demand. Sectors such as Information Technology, finance, and pharmaceuticals frequently provide higher remuneration due to a greater need for skilled workers. Conversely, traditional industries characterized by an oversupply of labor tend to offer lower wages. Given the substantial size of the state sector in comparison to other major economies, salaries within this sector are relatively elevated. In 2023, employees in the state sector earned, on average, nearly twice as much as their counterparts in the private sector. We analysed the possible relationship between the Average Wage of Employed Persons and the growth of the Number of Corporate Enterprises (see fig. 2.14).

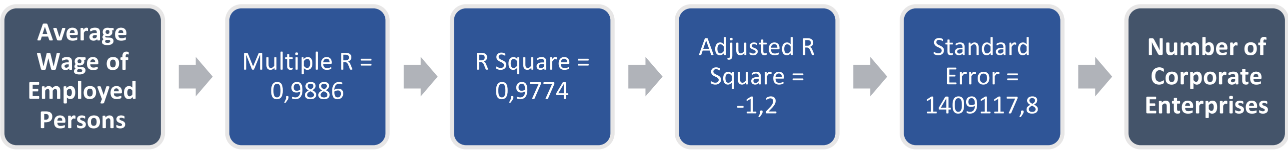


**Fig. 2.14. Regression Analysis between Average Wage of Employed Persons in Urban Units (yuan) and Number of Corporate Enterprises (units), China**

Source: [author]

The analysis showed a direct, tight relationship between the indicators, as the correlation coefficient and the coefficient of determination are more than 0.9 (see fig. 2.14). These comparisons are reinforced by the global differences in salaries and the economic factors that affect them, including the cost of living, the demand for specific skills, and the level of industrial development. Additionally, they mirror the overall economic conditions and labour market dynamics of each country, which contribute to the varied salary ranges that are observed. It is important to note that the average salary in China is significant not only in the context of hiring employees but also when determining compensation for contractors. Benchmarking contractor rates against the average employee salary is essential. Generally, contractors tend to earn approximately twice the hourly rate of an employee. It is essential for international firms entering the Chinese market to accurately assess salary benchmarks for the positions they are offering. Given the specific industry, numerous international companies may be recruiting for specialized roles and might need to offer compensation that exceeds the regional average [161].

The difficulties encountered by small enterprises in pursuing international business opportunities are extensively recorded. These challenges stem from the diverse business environments in which small firms function, differing across various countries and industries. In the service sectors, where firms led by women are predominantly found, there is evidence indicating that the regulatory framework has become less restrictive, thereby impeding the gradual increase in trade barriers noted in prior years. Service regulations have undergone significant changes in numerous countries. The liberalization of services, intended to enhance business operations and alleviate remaining obstacles to business travel following the COVID-19 pandemic, has been offset by the introduction of new trade barriers that restrict the movement of service providers and intensify scrutiny of foreign investments. Additionally, small and micro-sized enterprises face challenges in accessing international trade due to limited financial resources and difficulties in attracting skilled workers and fostering innovation. Informational barriers further complicate their ability to engage in international trade.

### 2.3. Geopolitical risks and internal challenges of fiscal policy impact on micro and small enterprises in China

Geopolitical risks continue to be significant (see fig. 2.15-A). An escalation of ongoing conflicts in the Middle East or the aggressive actions of Russia in Ukraine may result in a reevaluation of sovereign risk in the impacted areas and disrupt international energy markets. Although the global oil market currently seems sufficiently supplied, any harm to energy infrastructure could disrupt market equilibrium and prompt investors to reconsider global economic outlooks. The foundational economic forecasts presuppose stable prices for energy and food commodities throughout the projected period. Nevertheless, a sudden and significant increase in oil prices would considerably elevate global inflation and hinder economic growth, particularly in nations that rely on oil imports. This scenario would lead to diminished real incomes and stricter financial conditions, adversely affecting consumer expenditure and investment (OECD, 2024a). The repercussions could be even more severe if there were disruptions in oil supply or damage to shipping and transportation infrastructure. For instance, the Strait of Hormuz facilitates the transport of approximately 30% of the world's oil trade and 20% of liquefied natural gas, with no alternative routes available to deliver these quantities to the market. Any harm to tankers navigating through the Strait would further exacerbate the disruptions experienced in the global tanker market over the past year [144].

Increased trade protectionism, especially from the largest economies, represents a significant downside risk. Recently, trade policy uncertainty has escalated considerably, although it has not yet returned to the levels observed in 2018 (see fig. 1.15-B). More generally, the number of import-restrictive measures within G20 economies continues to grow (WTO, 2024). Currently, these measures are estimated to impact 12.7% of G20 imports, which is more than three times the extent of such measures in 2015. Additionally, there has been a notable rise in reforms to investment policies aimed at protecting national security (OECD, 2024d), which pose challenges to cross-border investment. The combination of heightened uncertainty and ongoing increases in trade-restrictive measures may lead to higher costs and prices, discourage investment, stifle innovation, and ultimately hinder economic growth. A further intensification of policy initiatives aimed at decoupling economies, particularly through foreign direct investment (FDI) and ownership restrictions in critical new growth sectors, could gradually impede global productivity growth and the ability of emerging-market economies to utilize trade for income enhancement [145].

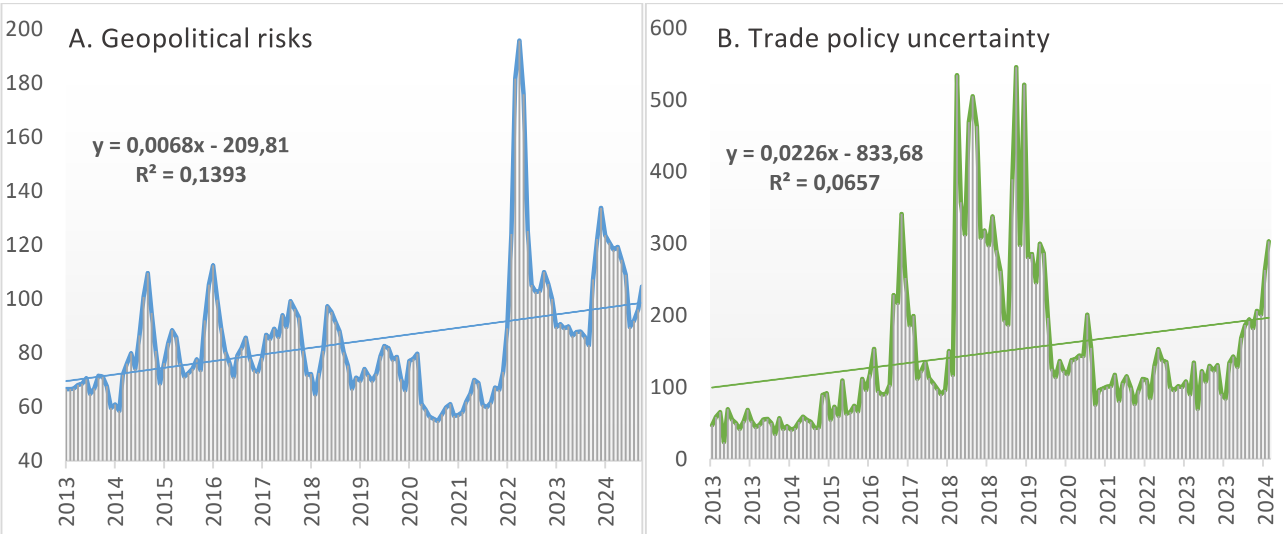


**Fig. 2.15. Dynamics of geopolitical risks and trade policy uncertainty**

Source: [author on https://stat.link/93ask1]

The transition to elevated interest rates is still ongoing, as borrowing rates continue to be renegotiated and low-yielding debt is maturing, subsequently being substituted by new loans for households and businesses. In certain market segments, asset valuations appear inflated, accompanied by low risk premiums, while the creditworthiness of some borrowers is declining. Any unexpected downturns in growth forecasts or deviations from the anticipated gradual disinflation trajectory pose risks of swift repricing in equity and corporate bond markets, leading to heightened volatility. The market turbulence experienced in early August 2024 served as a reminder of these repricing risks. Equity valuations are currently elevated across various economies and sectors, particularly in technology and healthcare. The anticipated growth in corporate earnings may be excessively optimistic (BIS, 2024). The high valuations, along with a significant concentration of equity market valuations in a limited number of companies, heightens the risk of idiosyncratic shocks to these firms leading to broader systemic issues (ECB, 2024c). Additionally, corporate debt markets may face mounting pressure due to rising risk premiums in the context of substantial debt levels and refinancing requirements, with around 30% of outstanding corporate bonds (valued at USD 12.3 trillion) set to mature by 2026 (OECD, 2024c). Although there has been an uptick in defaults, some forecasts indicate that they may have reached their peak (S&P Global Ratings, 2024a), yet concerns persist regarding the most vulnerable borrowers.

The assets held by non-bank financial intermediaries (NBFIs) have experienced substantial growth in recent years, particularly within the euro area, where they exceeded bank assets in 2022 across major advanced economies. NBFIs encompass a diverse array of financial institutions, many of which operate with less regulatory oversight compared to banks. This situation heightens their susceptibility to financial distress during periods of market volatility. The interconnectedness of NBFIs, as well as their links to banks, increases the risk of spillover effects, whereby vulnerabilities in one sector can propagate to others. A significant concern is that considerable asset repricing, coupled with concentrated exposures and rising volatility, may undermine the stability of non-bank financial institutions, particularly in scenarios where leverage is elevated and liquidity is constrained (ECB, 2024c). Certain market participants may be compelled to liquidate assets or withdraw liquidity from money-market funds to satisfy margin calls on leveraged positions, which could exacerbate volatility, lead to declines in asset prices, and create negative feedback loops [118].

Since mid-2022, the prices of commercial properties have been on a downward trend in various countries and specific market segments, especially in the office building sector. While the commercial real estate investments held by financial intermediaries have largely remained stable over the last ten years, amounting to approximately USD 21 trillion in 2023, there has been a gradual increase in the proportion of diverse non-bank investments. Currently, the overall quality of debt among commercial property developers is deteriorating due to stricter financing conditions and declining profitability. Additionally, delinquency rates have increased, particularly concerning office mortgages [134].

This year, there has been an increase in capital inflows into emerging-market economies, driven by robust growth, a favorable inflation outlook, and strengthened fiscal and monetary policy frameworks (Hardy, 2024). Additionally, shifting investor views regarding the anticipated speed of policy rate cuts in major advanced economies compared to those in numerous emerging markets have further bolstered portfolio capital inflows. Despite the generally positive outlook, there remain significant risks of diminished capital inflows and potential strain on exchange rates. This could occur if the anticipated interest rate differentials between emerging markets and advanced economies, especially the United States, narrow rapidly, or if geopolitical tensions escalate. Nations burdened with substantial sovereign debt, high spreads, and a significant proportion of USD-denominated debt are particularly susceptible to financial instability in the event of significant currency depreciation or capital flight. Over the past year, several countries have already experienced downward pressure on their currencies, particularly those facing relatively high inflation, below-average credit ratings, or elevated sovereign bond spreads compared to the United States. The unwinding of carry trade positions in 2024 has further exacerbated this pressure.

In 2023, total government debt continued to rise in emerging-market and developing economies, reaching 69% of GDP, with projections indicating an average increase to 75% of GDP by 2026 (IMF, 2024b). Numerous low-income nations are grappling with substantial debt loads and challenges in securing new financing. High interest rates and a robust US dollar are both detrimental to debt sustainability and limit the funds available for investment, particularly in sectors that promote growth. By the end of 2023, the debt of low-income countries is estimated to have climbed to 53.5% of GDP, with interest payments averaging over 10% of government revenue (IMF, 2024b and World Bank, 2024). The proportion of low-income countries identified as being at high risk of debt distress or already experiencing such distress has increased to over 50% in 2024. A further potential risk is the increasing interconnectedness between government entities and the domestic banking sector in several emerging-market economies over recent years. By mid-2024, domestic banks held nearly 30% of sovereign debt on average, a rise from 20% in 2004 (see fig. 2.16). Consequently, investor apprehensions regarding unsustainable levels of government debt may lead to sovereign stress that increasingly impacts the banking sector. Should a substantial decline occur, stricter borrowing limitations could hinder governments' capacity to provide support to banks through either implicit or explicit guarantees, thereby exacerbating stress within the banking system and obstructing credit growth.

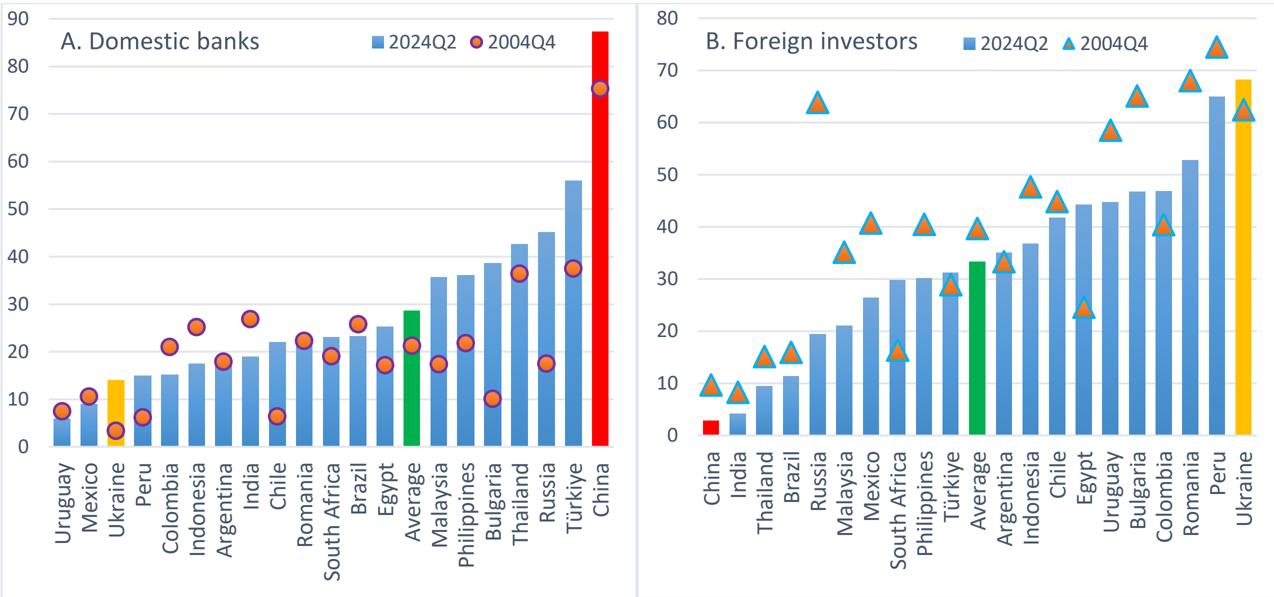


**Fig. 2.16. Sovereign debt holdings, emerging-market economies**

Source: [author on https://stat.link/5c7g0y]

The Chinese economy is projected to account for more than a quarter of global economic growth in 2024, with similar contributions anticipated for 2025 and 2026 according to baseline forecasts. As a result, developments within China are crucial for the overall global growth outlook. Specifically, for every 1 percentage point that China's GDP growth falls below expectations, the direct impact on global growth is estimated to be approximately 0.2 percentage points, along with potential indirect effects stemming from tighter financial conditions and declining commodity prices. Currently, the risks associated with these projections for China appear to be skewed towards the downside. Additional credit events could disrupt the orderly adjustment within the real estate sector, potentially increasing stress in certain areas of the financial sector and dampening consumer confidence. While an excessive easing of demand-side restrictions in the property market might lead to a temporary boost in growth, it could also result in a further accumulation of imbalances and a more pronounced adjustment in the future. An escalation in global trade restrictions would hinder export growth and industrial activity. Conversely, a planned fiscal expansion, combined with more rigorous measures to enhance spending efficiency, could amplify the effects of public expenditure and lead to growth that exceeds projections. Furthermore, the recent significant easing of monetary policy, which has reduced the mortgage interest burden on households, may also positively influence consumption growth in unexpected ways.

Several other unpredictable factors may lead to positive developments in the next two years. A rapid resolution of conflicts in the Middle East could alleviate global policy uncertainty and lower energy prices. Current fundamentals in the global oil market indicate a downward trend in prices, as global oil supply is expected to significantly exceed demand throughout the forecast period, even if OPEC+ members do not proceed with plans to lift production restrictions by the end of 2024 (IEA, 2024a). Furthermore, a revival of the Suez Canal's role in global shipping could enhance the resilience of international trade against future disruptions and reduce shipping expenses. The growth of domestic demand may experience an upswing if household saving rates decrease more than anticipated. In numerous countries, households still possess surplus savings that were accumulated at the beginning of the pandemic; however, a significant portion of these savings is concentrated among higher-income households, which tend to have a lower marginal propensity to consume. Nevertheless, if consumer confidence rebounds swiftly, household saving rates could decline more dramatically than expected [80].

This situation could arise if there is a further reduction in consumer food and energy prices, or if increases in household wealth resulting from a revival in real estate prices and robust growth in equity markets encourage households to allocate a smaller portion of their income to savings. While this would bolster demand growth, it could also lead to heightened inflationary pressures beyond what might have been anticipated. Favorable supply shocks may enhance potential output growth, allowing for more rapid expansions than currently forecasted. Private investment growth might react more robustly than expected to improved financing conditions, particularly if corporate investment thresholds become less stringent. Labor force participation rates could rise more significantly than anticipated. In many advanced economies, sustained high levels of inward immigration would contribute to this scenario, as immigrants are frequently more likely to be of working age [67].

In recent months, central banks across many advanced economies have either initiated or persisted in lowering policy interest rates, with Japan being a notable exception, as it is gradually withdrawing its policy accommodation. Additionally, reductions in central bank balance sheets have continued, with some regions adjusting the pace of these reductions or beginning the process. While the monetary policy stance remains restrictive in most nations, it is slowly becoming more accommodating. Current forward-looking real interest rates are still above the levels observed before the pandemic (see fig. 2.17). The cumulative impact of previous tightening measures on economic growth has now surpassed its peak; however, the ongoing refinancing of debt at elevated rates continues to burden numerous households and businesses, particularly in countries where significant renegotiation of mortgage rates, established prior to the onset of policy rate hikes, is taking place.

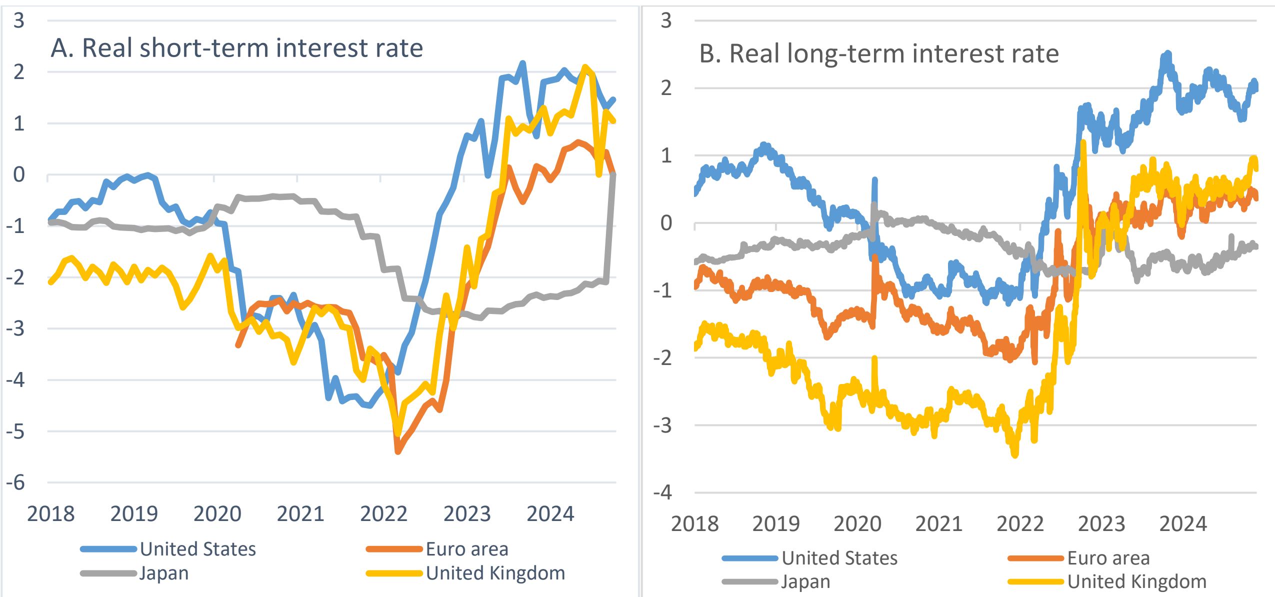


**Fig. 2.17. Real interest rates, advanced economies**

Source: [author on https://stat.link/k27fgh]

As inflation approaches the targets set by central banks, it is essential to continue reducing policy rates; however, the timing and extent of these reductions must be assessed with caution to ensure that fundamental inflationary pressures remain consistently managed. A further decline in nominal wage growth, the lack of a rebound in unit profits, and ongoing advancements in disinflation within the services sector where cost and price pressures have been alleviating gradually will be vital elements that facilitate a seamless implementation of monetary policy easing. By the conclusion of 2026, it is anticipated that real policy rates will generally align with the estimated ranges for neutral real rates, which represent the real interest rate where the policy stance is neither supportive nor restrictive. At that time, inflation is expected to return to target levels, with output gaps in most economies projected to be nearly zero. Nominal policy rates are likely to remain elevated compared to pre-pandemic levels, assuming inflation stabilizes at the target. This scenario would enhance the flexibility of monetary policy through traditional tools in the event of an unexpected economic downturn. Additionally, increased flexibility may arise if the future neutral rate exceeds current expectations, potentially due to reforms aimed at bolstering productivity and investment, including initiatives for climate change mitigation and adaptation (Holzmann, 2024), or an increased supply of public debt [5].

The fiscal forecasts for the years 2025-26 depend on the government initiatives that have been announced and the evaluations of current strategies by the OECD. Numerous countries are currently engaged in efforts to strengthen their budgetary positions. Nevertheless, the anticipated fiscal tightening in many nations is expected to be quite limited. Within advanced OECD economies, the median expected enhancement in the underlying primary balance is merely 0.3% of potential GDP from 2024 to 2026, with this improvement occurring exclusively in 2026. According to current forecasts, many governments within OECD nations are expected to continue experiencing primary deficits over the next two years. The slow pace of addressing existing budgetary imbalances will complicate efforts to stabilize or ultimately reduce debt levels. In certain countries, such as France, Latvia, the Slovak Republic, the United Kingdom, and the United States, significant budget deficits seem to be primarily structural, with any remaining fiscal capacity at moderate levels or projected to decline by 2025-26. The forecasts indicate that the gross general government financial liabilities for OECD countries collectively will reach 117% of GDP by the end of 2026, which is 9 percentage points higher than the levels recorded prior to the pandemic.

Fiscal policy priorities differ across nations (OECD, 2024a), yet many countries focus on reforms designed to promote extended working lives. This includes, in certain nations, increasing retirement ages to alleviate budgetary pressures associated with demographic shifts. Additionally, social policy reforms in numerous advanced economies are necessary to enhance the targeting of welfare programs. Modifications to sick leave and disability benefits should ensure that assistance is directed towards those in greatest need while simultaneously encouraging employment. In some countries, reforms in the health system are essential and could lead to greater efficiency in government spending. The constrained fiscal conditions in many nations necessitate a reallocation of expenditures towards initiatives that foster long-term growth. Tax reforms should seek to broaden tax bases and eliminate distortive tax expenditures, while also increasing revenue from indirect taxes. Many countries have the potential to enhance revenue through taxes on consumption, real estate, carbon emissions, or energy usage. Such taxes generally exert less negative impact on economic activity compared to taxes on wages and business profits. Improvements in tax administration and compliance could further enhance revenue generation capabilities [117].

Robust budgetary frameworks are essential for maintaining the momentum of fiscal consolidations, enhancing the credibility of fiscal strategies, and thereby minimizing uncertainty regarding fiscal policy implementation. Establishing numerical guidelines for budget balances and debt, along with oversight and evaluation by independent entities, can ensure that annual budget planning aligns with medium-term goals. Additionally, incorporating spending reviews into the budgeting process enables governments to identify inefficiencies and make informed decisions regarding the allocation of public resources. Although a decline in interest rates reduces the potential future expenses associated with debt financing, it will take time for this to be reflected significantly in the public finances of various countries. Since 2021, debt service costs have already increased considerably and are expected to rise further during 2025-26 in most economies, due to the current higher interest rates compared to those at the time the debt was issued. In several major economies, governments will face the challenge of financing substantial deficits while central banks continue to reduce their balance sheets, which will increase the amount of public debt that must be absorbed by domestic private investors or foreign purchasers. To maintain investor interest, higher bond yields may be necessary, particularly in the absence of clear plans for fiscal consolidation aimed at ensuring debt sustainability. This situation could partially counteract the benefits of monetary policy easing on the costs associated with new public debt issuance [144].

In recent quarters, the trajectories of monetary policy have increasingly varied among emerging-market economies, driven by diverse trends in inflation and exchange rates. Countries such as Chile, Colombia, and Mexico have continued to lower their policy rates, while Indonesia, Saudi Arabia, South Africa, and Thailand have also initiated rate cuts. Conversely, India has maintained its rates, and Brazil has implemented two rate hikes due to concerns regarding the potential effects of rising inflation on inflation expectations amid robust economic growth. In China, key policy interest rates and reserve requirements have been further reduced as part of a substantial stimulus initiative aimed at supporting the property sector and revitalizing the economy. The recent variations in monetary policy measures among the leading emerging-market economies stand in stark contrast to the concurrent tightening observed in the majority of economies during the inflationary period of 2021-22, as well as to previous cycles of easing, where interest rate reductions occurred in a highly coordinated manner (see fig. 2.18-A). There is potential for a reduction in policy interest rates in many economies over the next two years; however, it is crucial for policymakers to closely monitor inflation trends and exchange rate fluctuations to guarantee that inflation consistently aligns with target levels. A meticulous adjustment of monetary policy is vital to maintain stable inflation expectations and prevent significant capital outflows. If required, the pace of rate cuts may need to be moderated or even temporarily halted to uphold price stability. The anticipated rate of policy reductions differs among countries (see fig. 2.18-B).

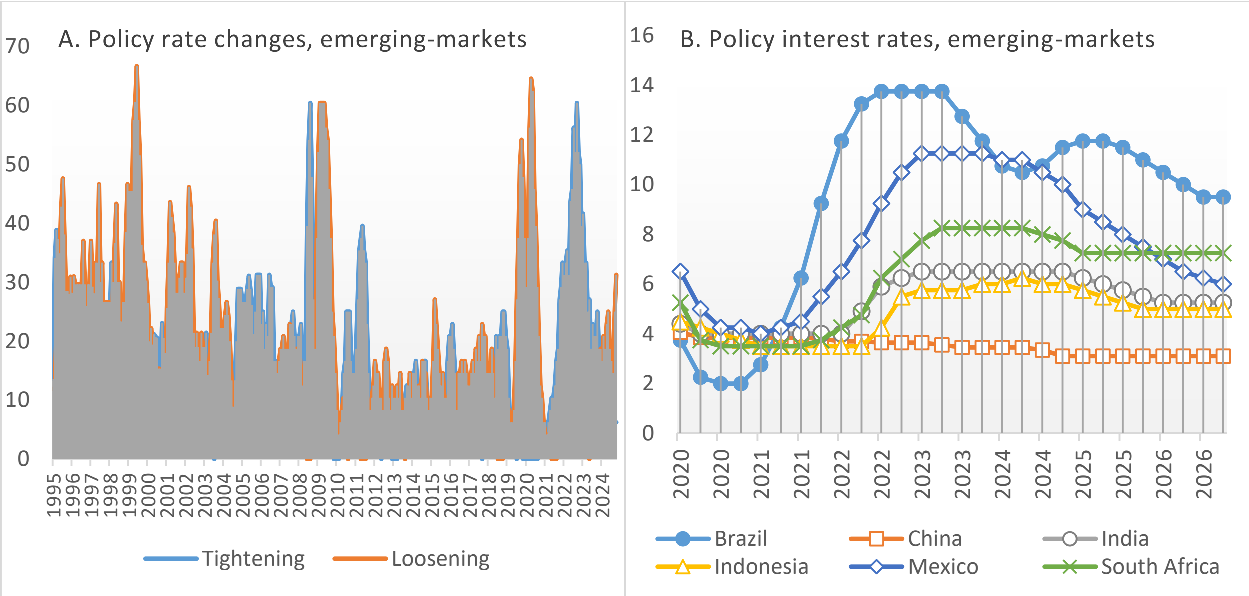


**Fig. 2.18. Monetary policy, emerging-market economies**

Source: [author on https://stat.link/h2jfq8]

Nominal policy rates in Brazil are expected to increase further in the upcoming months due to rising inflation, with gradual reductions anticipated only from mid-2025 onwards. In Chile, Colombia, and Mexico, interest rate cuts are likely to proceed at a consistent pace until late 2025 or 2026, bringing policy rates down to 4.25%, 5.5%, and 6%, respectively, which are close to neutral levels. In Indonesia and South Africa, modest rate reductions are anticipated, as inflation has recently decreased more rapidly than previously expected. Additionally, rates in India are projected to decline as inflation subsides over the next two years. In Turkey, where inflation remains high, the policy rate is expected to stay at 50% until the first quarter of 2025, before decreasing to 20% by the latter half of 2026 as inflationary pressures diminish. Recent fiscal trends have shown significant variation among emerging markets. In Brazil, Costa Rica, Chile, South Africa, and Turkey, fiscal deficits widened in 2023, largely due to the continuation of pandemic-related support measures, increases in pensions and public salaries, and, in the case of Turkey, considerable expenditures related to earthquake recovery. Conversely, fiscal positions improved in Bulgaria, Colombia, India, and Indonesia. Several nations are anticipated to experience rising deficits in 2024. In China, there have been announcements regarding a shift in spending towards infrastructure and direct income support, accompanied by a notable increase in the issuance of local government bonds and initiatives aimed at alleviating the debt service burden on local authorities. In contrast, Brazil is expected to see a reduction in its fiscal deficit in 2024, despite maintaining an expansionary policy stance and ongoing pressure on social spending from the automatic indexation of pensions and social benefits [134].

In China tax resident enterprises (TREs) are liable for corporate income tax (CIT) on their global income. Conversely, a non-TRE without any establishment or presence in China is taxed solely on income sourced from China. However, a non-TRE that does have an establishment or presence in China is required to pay CIT on income generated by that establishment or presence from Chinese sources, in addition to income from outside China that is effectively linked to that establishment or presence. According to the Corporate Income Tax (CIT) legislation, the standard tax rate is set at 25%. However, certain sectors and industries can benefit from a lower CIT rate on a national level. New and high-tech enterprises that meet specific criteria and undergo an assessment can qualify for a reduced CIT rate of 15%. Designated key software enterprises and designated integrated circuit (IC) design enterprises that are encouraged can enjoy a reduced CIT rate of 10% after an initial five-year period of CIT exemption (see fig. 2.19). Technology-advanced service enterprises that meet the required criteria and pass an assessment are eligible for a CIT rate of 15%. Small enterprises with thin profit margins can benefit from an effective CIT rate of 5% on annual taxable income up to 3 million yuan (CNY) from January 1, 2023, to December 31, 2027. Enterprises focused on pollution prevention and control can access a preferential CIT rate of 15% from January 1, 2019, to December 31, 2027. A reduced Corporate Income Tax (CIT) rate is offered in certain regions for specific sectors and industries. From January 1, 2011, to December 31, 2030, enterprises recognized as encouraged in the Western Regions can benefit from a preferential CIT rate of 15%. From January 1, 2014, to

December 31, 2025, encouraged enterprises with operational substance located in the Qianhai Shenzhen-Hong Kong Modern Services Industry Cooperation Zone are also eligible for a reduced CIT rate of 15% [17].

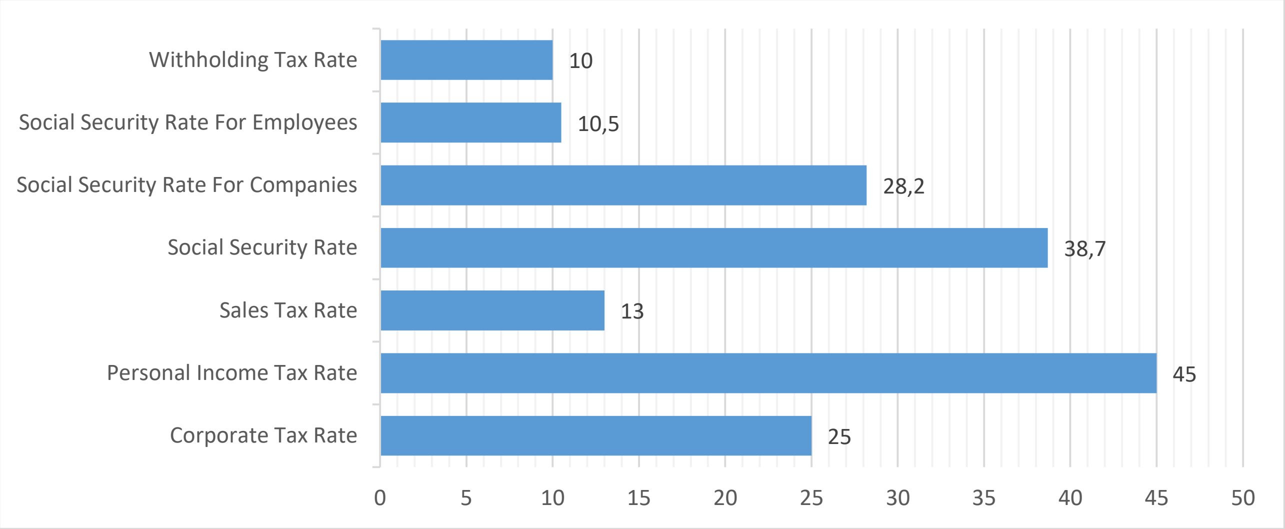


**Fig. 2.19. China Corporate Tax Rate**

Source: [author on https://tradingeconomics.com/china/corporate-tax-rate]

Similarly, encouraged enterprises established in the Guangdong-Macao Intensive Cooperation Zone in Hengqin, provided they have operational substance, qualify for a 15% reduced CIT rate. From January 1, 2014, to December 31, 2025, encouraged enterprises with operational substance in the Pingtan Comprehensive Experimental Zone can take advantage of a 15% reduced CIT rate. Additionally, from January 1, 2020, to December 31, 2024, encouraged enterprises registered in the Hainan Free Trade Port, which possess operational substance, are eligible for a 15% reduced CIT rate. From January 1, 2022, to December 31, 2026, encouraged enterprises with operational substance in the trial-run areas of Nansha (spanning 23 square kilometers) can benefit from a reduced CIT rate of 15%. From January 1, 2023, to December 31, 2027, encouraged enterprises with operational substance located in the designated closed area of the Shenzhen park within the Hetao Shenzhen-Hong Kong Science and Technology Innovation Cooperation Zone are eligible for a 15% reduced CIT rate. Starting from January 1, 2020, qualified enterprises engaged in significant production or research and development (R&D) activities in key industries such as integrated circuits, artificial intelligence, biomedicine, and civil aviation within the Lingang New Area of the Shanghai Pilot Free Trade Zone can avail themselves of a 15% reduced CIT rate for five years from their establishment date [117].

Private enterprises, which are essential for job creation, investment, and innovation in China, have expressed worries that the regular administrative inspections conducted by local authorities disrupt their operations and foster rent-seeking behavior. The Government has recognized issues such as the prevalence of arbitrary inspections, as well as "campaign-style inspections" and those conducted under various pretexts. It has called on local governments to abolish "profit-driven inspections" that are intended to impose fines as a means of addressing fiscal challenges and local debt issues. China has announced its intention to amend and repeal 25 administrative regulations to enhance standardized and fair law enforcement, improve the legal business environment, and encourage a high-level engagement with the global market. Among the 21 revised regulations are those related to the oversight of medical devices, the management of publishing, and modifications to specific penalty frameworks. Seven of these regulations, including one that governs business premises for internet access services, are based on successful pilot initiatives from free trade zones and will now be applied across the country. Significant changes involve the removal of certain approval requirements and the shift of others to a record-based management system, which aims to further invigorate business activity. The four repealed administrative regulations include provisions concerning institutions that oversee public health promotion programs.

Chinese manufacturers obtain government support that is nine times greater than that of their Western counterparts, as indicated by calculations from the Organization for Economic Co-operation and Development (OECD). This substantial backing contributes to China's overwhelming dominance across various industries, including solar panels, batteries, and steel. According to the OECD's data, Chinese enterprises receive government subsidies averaging 3.7% of their revenues. In contrast, businesses in wealthier nations receive an average of merely 0.4% in state aid relative to their revenues. The data play a crucial role in elucidating China’s dominance in specific industries, as well as in explaining the rapid decline of the UK’s manufacturing sector in recent years. While China offers substantial support to vital industries, such as its solar photovoltaic sector and producers of base metals like aluminum and steel, UK governments have historically adopted a much less interventionist approach. Consequently, the UK has experienced numerous plant closures, struggling to compete with low-cost imports. To date, there has been no conclusive assessment of the extent to which these inexpensive imports have been affected by what economists refer to as “state aid”, which involves government assistance to domestic companies [109].

In its most basic form, this can manifest as direct financial assistance from governments to aid a company or facilitate the construction of a facility. Nonetheless, the level of transparency regarding these grants varies significantly among countries. More critically, however, are the preferential low tax rates that may be applied to certain companies or industries, as well as the below-market interest rates occasionally extended to selected firms. So, China offers considerably more state support to its manufacturers, is probably not unexpected; however, it offers a statistical foundation for claims that the global trading system inadequately addresses these interventions. The analysis reveals that the level of state aid differs considerably across various sectors, with aluminum smelters, cement producers, and solar cell manufacturing facilities being the primary beneficiaries of this support. China has made substantial improvements to its financial support initiatives for micro and small-sized enterprises in an effort to enhance economic vitality. The limit for inclusive micro and small loans has been raised from 10 million yuan (approximately 1.4 million U.S. dollars) to 20 million yuan per borrower. Additionally, refinancing programs for agricultural and small businesses have benefited from reduced interest rates, which further eases the financial pressures on these vital economic contributors. In 2024, China launched a re-lending program valued at 500 billion yuan to foster technological innovation and industrial advancement, with 100 billion yuan specifically allocated to support the growth of technology companies. Recently, an initial list of nearly 7,000 eligible enterprises under this program was provided to banks.

**Conclusions to chapter 2**

The analysis highlights the significant role of fiscal policy and government net lending in managing economic performance and supporting social priorities. Local authorities in China are empowered to allocate special bond funds for strategic purposes such as land reserves and affordable housing, signalling a proactive fiscal approach to address housing and social infrastructure needs. To further stabilize employment and boost consumption, the government is encouraged to enhance income levels, strengthen social security, and support the emergence of new consumption drivers. A key component of fiscal policy, government net lending defined as the difference between government revenue and expenditure serves as a barometer of fiscal health. When expenditures exceed revenues, deficit financing is often used to stimulate the economy, particularly when funds are channelled into productive investments like infrastructure. While this can spur economic growth, excessive reliance on deficit spending may strain long-term fiscal sustainability. Conversely, during economic downturns, expansionary fiscal policy manifested through increased spending and tax cuts is essential to compensate for weak private sector demand and promote Real GDP growth. In such conditions, fiscal intervention becomes more effective than monetary policy. However, in times of economic stability, maintaining a surplus can reduce national debt, supporting long-term economic resilience. Thus, the effectiveness of fiscal policy is context-dependent and must be carefully calibrated.

The financing of micro, small, and medium-sized enterprises in China remains a persistent challenge, primarily due to their high-risk and low-return profile in the eyes of lenders. This issue has become more pressing following the economic disruptions caused by the COVID-19 pandemic. Despite policy efforts to provide financial support, small and medium-sized banks continue to face rising non-performing loan ratios and declining net interest margins, limiting their willingness to lend to MSEs. The government has committed to fostering innovation within the MSE sector, aiming to develop one million innovative enterprises by 2025 under the “14th Five-Year Plan.” Encouragingly, the loan rejection rate for MSEs remained relatively low at 3.6% in 2022, and their loan utilization rate stayed high at 87.7%. However, interest rates for

MSEs remained slightly above those for large enterprises, highlighting ongoing financial disparities. Private businesses now constitute over 96% of all business entities in China, underscoring the sector's growing significance. Furthermore, a strong correlation exists between rising average wages and the growth in the number of corporate enterprises, suggesting that economic growth, driven by industrial development and skilled labour demand, positively impacts both wages and business expansion. Continued support for MSEs is essential for sustaining China's long-term economic resilience and innovation capacity.

Geopolitical risks remain a major concern for the global economic outlook. Escalations in the Middle East or intensified Russian aggression in Ukraine could trigger a reassessment of sovereign risks and disrupt global energy markets, posing serious implications for regional and global stability. Additionally, the rise of trade protectionism, particularly among leading economies, introduces further downside risks to global trade and economic cooperation. The ongoing adjustment to a high-interest-rate environment is creating new financial pressures. As older, low-interest debt matures, it is being replaced by higher-cost borrowing for both households and businesses, potentially constraining consumption and investment. A sharper-than-expected slowdown in economic growth or deviations from the anticipated disinflation path could trigger sudden market corrections, especially in equities and corporate bonds, increasing financial market volatility. Monetary policies are diverging globally. While many advanced economies have started lowering interest rates, Japan remains an outlier, slowly phasing out its accommodative stance. In contrast, emerging markets show mixed policy directions due to differing inflationary pressures and currency dynamics. Fiscal policies also reflect growing pressures. Many governments are implementing reforms aimed at long-term fiscal sustainability, such as raising retirement ages to cope with aging populations. These policy shifts highlight the complexity of managing fiscal and monetary stability amid persistent global uncertainties.

The main scientific results were published in the following scientific articles: 162; 163; 164; 165; 166; 167; 168; 169; 170; 171.

# CHAPTER 3
# PROSPECTS OF DEVELOPMENT THE FISCAL POLICY AND MSEs UNDER GLOBAL CHALLENGES

## 3.1. Ways of Policy Adjustments the development of MSEs in China

Policy measures and communication strategies were tailored to reflect local conditions. The central government established an online policy repository on the State Council’s official website to consolidate relevant policies for MSEs, while delegating the implementation of specific measures to local governments. To encourage local action, performance evaluation criteria for local authorities were adjusted to prioritize economic revitalization over strict COVID-19 containment. Moreover, the central government dispatched teams to various regions to better understand the distinct needs of local businesses and strengthened the role of business associations in addressing these concerns. For example, the Shenzhen Municipal Government introduced a rapid response mechanism requiring government agencies to respond within 24 hours to specific MSE requests related to the resumption of business operations.

Operational costs for micro, small, and medium-sized enterprises (MSEs) declined as a result of targeted support measures. In cities like Beijing and Shanghai, rental fees were waived for MSEs operating in state-owned properties. Authorities also introduced reductions in value-added tax (VAT) and provided VAT exemptions for small-scale taxpayers in selected regions, including Hubei province. Local governments were encouraged to reduce regional taxes and fees. Additional cost-relief initiatives included a 5% reduction in electricity tariffs, options for deferred utility payments, the temporary suspension of highway tolls, and expanded subsidies for vocational training programs [170].

Consumer demand saw a notable surge. By mid-April, more than RMB 10 billion (approximately USD 1.4 billion) in shopping vouchers had been distributed to residents in around 80 cities across China. These consumption coupons not only stimulated general public spending but also specifically supported sectors hit hardest by economic disruptions, creating a significant multiplier effect across the broader economy. To further bolster consumption, the government facilitated MSE access to digital platforms by reducing entry barriers such as lowering per-order commission fees and easing deposit requirements related to product quality concerns to enhance their online sales and marketing efforts. Additionally, authorities promoted the prioritization of MSEs in all government procurement activities (see Fig. 3.1).

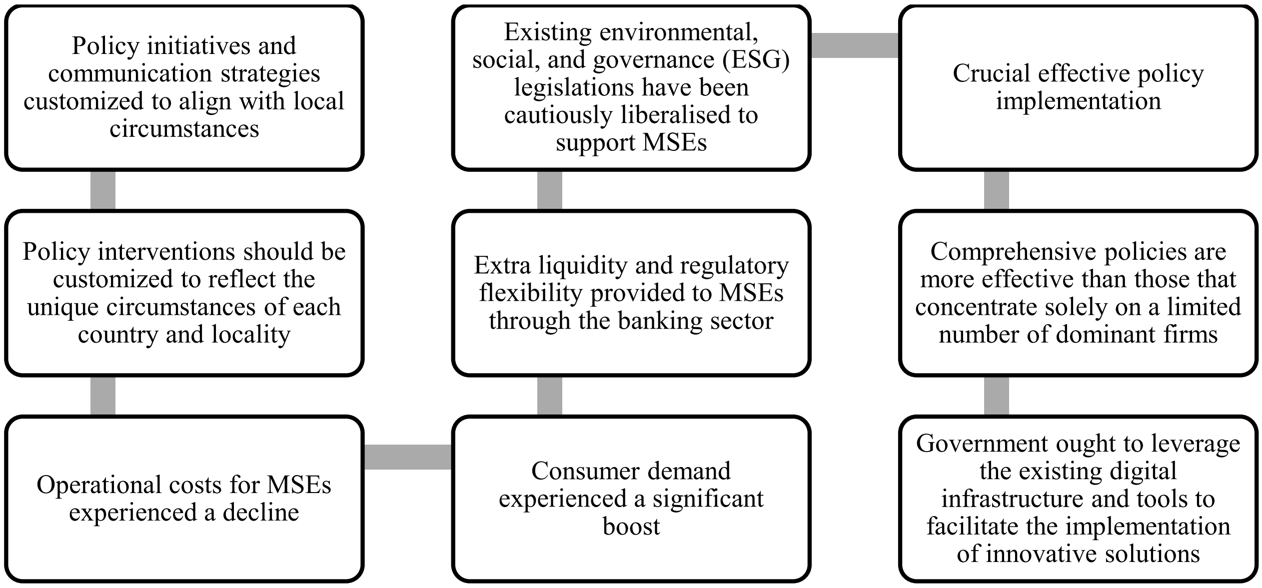


**Fig. 3.1. Model of PRC support for MSEs under crisis**

Source: [Author].

Existing environmental, social, and governance (ESG) regulations have been selectively relaxed to support small and micro-sized enterprises. For example, to meet requirements related to table spacing in dining establishments, the Chengdu government revised urban appearance regulations, allowing restaurants to set up outdoor seating. To improve financing access, the authorities designated the pandemic as a force majeure event, thereby shielding bank counter managers from legal responsibility for the accumulation of non-performing loans (NPLs). This measure aligns with the broader regulatory flexibility granted by the Central Bank regarding NPL management in commercial banks. Effective policy implementation requires coordination across all levels of government to strike a balance between epidemic control and economic recovery. It also demands clearly defined responsibilities among stakeholders and a unified policy approach. Interventions should be tailored to the distinct conditions of each country and region. For example, in economies with high household savings rates, reopening efforts should be coupled with measures to stimulate consumer spending. At the same time, locally specific strategies are essential to address varying regional needs.

Governments should capitalize on existing digital infrastructure and tools to support the rollout of innovative solutions. In the People's Republic of China, for instance, authorities leveraged digital technologies to develop a health code system for evaluating individual employee risk levels and used big data analytics to enhance health inspections. Additionally, digital platforms were established to align labor supply with demand and to provide point-to-point and one-stop transportation services, particularly benefiting migrant workers. The government also promoted the use of digital tools to facilitate remote work among micro and small-sized enterprises. Holistic policies targeting entire industries or supply chains tend to be more effective than those focused solely on a few dominant firms. Due to the interdependent nature of industrial production, large enterprises rely heavily on the network of MSEs that form their supply chains. Therefore, it is essential that policy efforts aim to reactivate economic activity across the entire industrial ecosystem, regardless of enterprise size, rather than focusing exclusively on leading firms [171].

To mitigate the risk of a renewed epidemic crisis, it is crucial for the government to focus on the sustainable development of micro and small-sized enterprises. Achieving sustainable growth in the People's Republic of China requires a strategic shift from dependence on external demand toward the cultivation of domestic consumption, moving away from an investment-driven, export-oriented model. Strengthening domestic demand will enhance China's resilience to global supply chain disruptions. Accordingly, policy support for MSEs should emphasize demand-side solutions, aiming to stimulate local markets and expand domestic consumption capacity. In parallel, such policies should encourage and support innovation among MSEs, while also reducing the costs associated with research, development, and technological advancement.

MSEs have played a vital role in driving economic growth in the People's Republic of China. However, their structural fragility makes them particularly vulnerable to external shocks, such as the liquidity challenges intensified by the COVID-19 pandemic. This vulnerability is especially acute among innovative MSEs, start-ups, micro-enterprises, businesses in rural areas, and those engaged in localized services.

The adoption of advanced technologies and digital tools can help cushion the adverse impact of the pandemic on these enterprises. In this regard, government policy is instrumental in supporting their sustainable development. Policymakers should consider mandating banks to extend credit to MSEs or introducing strong incentives that encourage voluntary lending to this sector, thereby increasing the share of bank financing directed toward MSEs. Financial institutions that provide loans to MSEs could be eligible for business tax exemptions. Similarly, organizations and individuals who transfer or lease patents to MSEs might also benefit from business tax deductions or exemptions.

Small and micro-sized enterprises serve as the foundation of China's economy; however, these businesses encounter considerable challenges, including financing shortages, complex regulations, and competition from state-owned enterprises (SOEs). As China deals with a slowdown in growth and increasing global trade tensions, it is essential to implement policy changes that support the development of MSEs. These enterprises find it difficult to compete with SOEs, which account for 30% of production and procurement contracts. Modifying policies to create a more equitable environment can enhance opportunities for MSEs [75].

Additionally, MSEs are behind in terms of skills and technology, with only 30% being technologically proficient compared to 70% of SOEs. Implementing capacity-building initiatives can help bridge this divide. Furthermore, rural MSEs and women-led businesses experience disparities in access to resources, as rural credit availability is lower than in urban areas. Inclusive policies, such as tax reductions for women entrepreneurs, can help address these inequalities. As a result, we propose Ways of Policy Adjustments for the development of MSEs in China (see fig. 3.2).

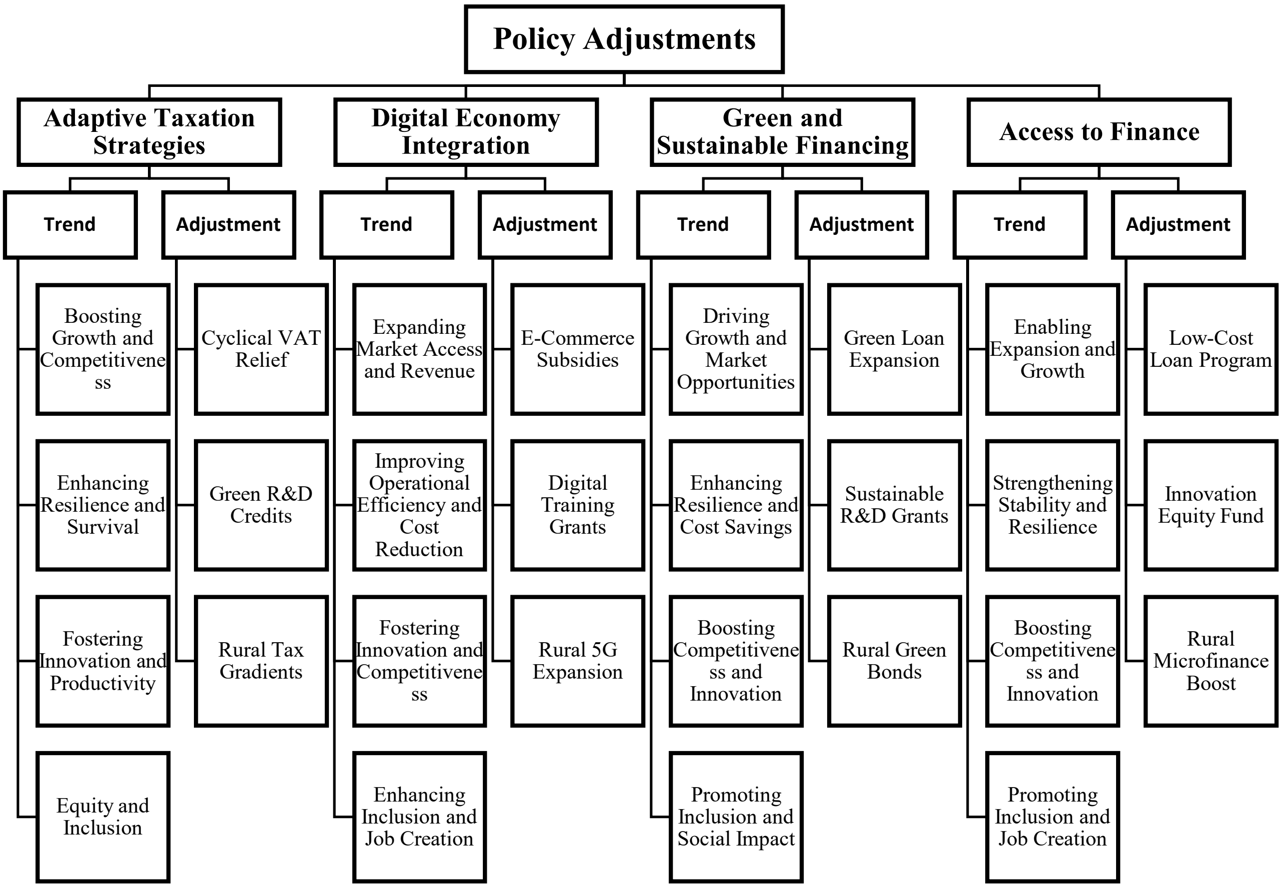


**Fig. 3.2. Ways of policy adjustments the development of MSEs in China**

Source: [Author].

*Adaptive Taxation Strategies*. Adaptive taxation strategies – flexible tax policies that respond to economic circumstances, the size of firms, or specific sector requirements provide a dynamic method for supporting micro, small, and medium-sized enterprises. These enterprises represent 90% of businesses worldwide and are responsible for 60-70% of employment, making them crucial for economic development. In China, MSEs account for 60% of the GDP and 80% of urban employment, yet they encounter difficulties such as decelerating growth and a complicated tax framework. Adaptive taxation has the potential to stimulate the growth of micro, small, and medium enterprises by alleviating fiscal burdens and enabling capital to be redirected for reinvestment. Implementing temporary tax reductions during economic downturns, such as a 50% reduction in value-added tax, can enhance cash flow by 10-15%, as demonstrated by Germany's COVID relief measures in 2020.

In China, MSEs experienced losses amounting to ¥1 trillion following the 2022 lockdowns, but a tax relief initiative in 2023, totalling ¥600 billion, resulted in an 8% increase in MSE output. Additionally, progressive tax rates that increase with revenue can lessen financial pressures; for instance, India's tiered tax system for MSEs, ranging from 1% to 5%, improved compliance rates by 20%. To foster MSE development, tax policy must evolve towards greater flexibility. In China, reducing the 13% VAT for small enterprises with revenues below ¥5 million could potentially release ¥500 billion annually for growth, thereby improving their competitiveness against state-owned enterprises, which account for 30% of total output. Nevertheless, excessive tax relief poses a risk of revenue loss, as evidenced by China’s fiscal deficit reaching 6% of GDP in 2023. Therefore, it is essential to implement targeted measures to prevent the subsidization of non-viable businesses [171].

Adaptive taxation enhances the resilience of micro, small, and medium enterprises by providing a buffer against economic disruptions. The implementation of deferred tax payments (six-month grace periods) helped prevent the closure of 30% of small businesses in the US during 2020. Additionally, targeted relief measures, including tax incentives for green technology, can redirect MSEs towards emerging markets with high demand. In China, where 20% of MSEs ceased operations following the COVID-19 pandemic, a deferral package worth ¥500 billion in 2022 helped safeguard 1 million jobs. This approach significantly improves the survival chances of MSEs, advocating for a more adaptable tax policy. For China, prolonging deferral measures amid trade conflicts, such as the U.S. tariffs on $200 billion worth of exports in 2024, could potentially protect 10% of MSEs reliant on exports. The complexity of administration poses a challenge – tracking eligibility increased costs by 3% in the EU – the need for digital tax platforms to facilitate efficient implementation [17].

Adaptive taxation has the potential to enhance innovation among MSEs by promoting R&D and digital transformation. For instance, in the UK, tax credits for R&D, set at 20%, have resulted in a 15% increase in innovation among small firms since 2015. In China, where MSEs are behind SOEs in technology adoption 5% compared to 20% in R&D expenditure a digital tax incentive of ¥200 billion introduced in 2023 has led to a 10% rise in e-commerce start-ups. Additionally, reduced tax rates for rapidly growing sectors such as artificial intelligence and biotechnology have proven effective in attracting talent; Singapore's 5% technology tax has successfully attracted 500 MSEs over five years. Incorporating innovation into tax policy is crucial for the development of MSEs. China's goal of achieving carbon neutrality by 2060 could utilize green R&D tax credits to enhance solar energy production among MSEs, which currently represent 60% of the global market, potentially increasing output by 20%. However, there are risks associated with misallocation of resources, as evidenced by the ¥100 billion lost in unsuccessful EU projects, highlighting the need for performance-based evaluation criteria [90].

Adaptive taxation fosters equity among MSEs by focusing on marginalized groups, such as rural businesses and those led by women. Implementing graduated tax rates in low-income areas, such as the western provinces of China, which have a GDP per capita 40% lower than coastal regions, could potentially increase rural MSE revenues by 10%. Additionally, gender-targeted tax relief, exemplified by India's 2% reduction for women entrepreneurs, has resulted in a 12% increase in female-led enterprises. This approach enhances inclusivity within the MSE sector, aligning tax policies with broader social objectives. In China, where rural MSEs account for 30% of the workforce, customized tax relief could help bridge the gap between urban and rural economies. Nevertheless, the potential for bias, such as urban favouritism in the 2023 relief measures, underscores the necessity for transparent allocation processes to guarantee equity [90].

So, under adaptive taxation strategies are useful for development MSEs and as result we could give some proposals for China. *(1) Cyclical VAT Relief* – to introduce a 50% reduction in VAT for MSEs with revenues below ¥10 million during economic downturns, such as the anticipated trade slowdown in 2025. This initiative would require an investment of ¥300 billion but is projected to enhance output by 5-7%. Funding could be sourced from taxes on urban SOEs. *(2) Green R&D Credits* – to provide a 20% tax credit for MSEs engaged in renewable energy or electric vehicle sectors, with an estimated annual cost of ¥200 billion. This initiative aims to achieve a

15% growth in these sectors by 2030, in line with net-zero emissions objectives. The credits would be linked to patent registrations or export activities. *(3) Rural Tax Gradients* – to decrease the corporate tax rate from 25% to 15% for rural MSEs located in western provinces, which would entail a fiscal impact of ¥150 billion. This measure is expected to create 500,000 new jobs and recover approximately 60% of the costs through increased payroll tax revenues. Adaptive taxation strategies have the potential to significantly enhance the development opportunities for micro, small, and medium enterprises by promoting growth, resilience, innovation, and equity; however, they must be meticulously crafted. In China, where MSEs account for 80% of employment but are under fiscal and market strain, initiatives such as cyclical relief, green credits, and rural gradients could generate an economic value of ¥1 trillion by 2030 while mitigating revenue risks. Tax policies need to progress towards greater flexibility, digital efficiency, and inclusivity, ensuring a balance between supporting MSEs and maintaining fiscal sustainability. As China refines its MSE policies in 2025, adaptive taxation will be crucial for their success [169].

*Digital Economy Integration*. The integration of the digital economy, which involves the incorporation of digital technologies such as e-commerce, cloud computing, and artificial intelligence (AI) into business practices, presents significant opportunities for micro and small-sized enterprises. In China, MSEs contribute to 60% of the GDP and account for 80% of urban employment. The digital economy in the country is a formidable force valued at $7 trillion, representing 22% of the GDP, with major players like Alibaba and Tencent at the forefront. Digital integration facilitates access to global markets for MSEs by lowering entry barriers. E-commerce platforms such as Alibaba's Taobao have enabled 10 million Chinese MSEs to connect with 1 billion consumers by 2023, resulting in an annual sales increase of 15%. The cross-border e-commerce sector, which is expanding at a rate of 20% per year, contributed ¥1.2 trillion to MSE exports in 2023. In advanced economies, the adoption of digital technologies has led to a revenue increase of 10-20% for MSEs, exemplified by Etsy's 2 million small sellers globally. This digital transformation presents significant growth opportunities for MSEs. In China, incorporating rural MSEs representing 30% of the sector into platforms like Pinduoduo could potentially generate an additional ¥500 billion in sales by 2027. Nevertheless, the fees associated with these platforms (ranging from 5-10% per transaction) and the competition posed by larger companies may pressure profit margins, highlighting the need for policies that promote equitable access and pricing [147].

Digital tools significantly improve the efficiency of MSEs by automating various processes and reducing expenses. For instance, cloud-based accounting solutions, such as Xero, can lower administrative costs by 25%. Additionally, AI-enhanced logistics systems, exemplified by JD.com smart warehousing, can decrease delivery expenses by 15%. By 2023, 40% of MSEs in China had embraced digital payment methods like WeChat Pay and Alipay, resulting in savings of ¥200 billion in transaction fees. This transition not only strengthens the resilience of MSEs but also facilitates their growth. In China, where labour costs have increased by 10% since 2020, the adoption of cloud technologies could potentially save ¥300 billion each year, allowing for reinvestment of those funds. However, challenges persist, including initial costs averaging ¥50,000 per firm for digital tools and a lack of technical skills, with only 30% of MSEs being proficient in technology. To fully realize the benefits, it is essential to provide subsidized training and improve infrastructure [161].

Digital integration fosters innovation among MSEs by facilitating data-driven decision-making and the introduction of new products. Artificial intelligence analytics enable small retailers to forecast demand with an accuracy of 85%, while 3D printing technology reduces prototyping expenses by 30%. In Shenzhen’s technology hub, MSEs have utilized digital platforms to achieve a 10% annual increase in patent registrations since 2020. The digital tax incentive of ¥200 billion introduced in 2023 has led to a 12% growth in e-commerce startups. This advancement enhances the competitiveness of MSEs. Although China’s MSEs currently invest only 5% of their revenue in research and development compared to 20% for SOEs, they have the potential to bridge this gap through AI subsidies, aiming for a 15% increase in innovation by 2030. However, challenges such as data privacy where 70% of MSEs experience breaches and excessive dependence on major technology companies necessitate the implementation of regulatory protections.

Digital integration enhances the inclusivity of MSEs by linking underserved areas and populations. In China, rural e-commerce initiatives such as Taobao Villages have generated 6 million jobs and increased incomes by 20%. Women-led MSEs, which represent 25% of the sector, experienced a 15% growth through digital platforms in 2023. This development amplifies the social impact of MSEs. In China, addressing the digital divide where rural internet access lags behind urban areas by 30% could potentially create an additional 2 million jobs by 2027. Nevertheless, the urban-centric approach to digital infrastructure deployment, with 80% of 5G networks concentrated in cities, poses a risk of exacerbating existing disparities, necessitating policies aimed at ensuring equitable access [149].

So, under digital economy integration are useful for development MSEs and as result we could give some proposals for China. *(1) E-Commerce Subsidies* – to provide ¥300 billion in waivers for platform fees for MSEs with revenues below ¥5 million from 2025 to 2027, aiming for ¥600 billion in sales and a 10% increase in exports. This initiative will be financed through urban consumption taxes. *(2) Digital Training Grants* – to designate ¥200 billion to equip 5 million MSE employees with training in artificial intelligence and cloud technologies by 2028, enhancing productivity by 15% and recovering 50% of the investment through payroll taxes. *(3) Rural 5G Expansion* – to allocate ¥400 billion for the development of rural broadband infrastructure by 2030, connecting 10,000 villages to e-commerce platforms, which is expected to generate an additional ¥500 billion in revenue for MSEs and create 1 million jobs, in line with rural revitalization objectives.

The integration of the digital economy has the potential to transform the development of MSEs by broadening market access, improving operational efficiency, encouraging innovation, and enhancing inclusivity. However, this transformation requires significant investment and appropriate regulatory frameworks. In China, where MSEs account for 80% of employment and digital platforms are at the forefront globally, initiatives such as e-commerce subsidies, training grants, and the expansion of rural 5G services could generate an estimated ¥1.6 trillion in value by 2030, thereby bolstering resilience and competitiveness. It is essential for policy to strike a balance between access, skill development, and equity to fully realize these benefits. As China advances its digital economy by 2025, the integration of MSEs will be crucial for achieving sustainable growth.

*Green and Sustainable Financing*. Green and sustainable financing, which includes funding options such as green loans, bonds, and grants designed for environmentally conscious initiatives, provides essential support for micro, small, and medium-sized enterprises to adapt to global sustainability trends. In China, green financing is projected to reach ¥2.5 trillion by 2024, contributing to the goal of achieving carbon neutrality by 2060. Green financing fosters the growth of micro, small, and medium enterprises by creating opportunities in markets for sustainable products and services. Low-interest green loans, such as those with rates of 2% compared to the standard 5%, allow small businesses to invest in solar energy systems or energy-efficient technologies, thereby accessing a global green market valued at $1 trillion. In China, MSEs within the solar industry, which account for 60% of the world's solar panel production, experienced a 15% increase in revenue in 2023 following the allocation of ¥500 billion in green loans. This development opens up new revenue opportunities for MSEs. In rural China, which comprises 30% of the MSE sector, there is potential access to ¥300 billion in green financing for the production of organic products, which could generate an additional ¥400 billion in sales by 2030. However, significant eligibility challenges exist, as 50% of MSEs do not possess green certification, posing a risk of exclusion. Therefore, it is essential to establish simplified criteria to enhance participation in these financing opportunities [161].

Sustainable financing enhances the resilience of micro, small, and medium enterprises by providing funds for efficiency improvements that lower operational expenses. Grants aimed at retrofitting, such as the installation of LED lighting or waste recycling systems, have been shown to decrease energy costs by 20-30%, as evidenced by small businesses in the European Union. In China, a green grant initiative worth ¥200 billion in 2023 enabled 1 million MSEs to reduce their expenses by 10%, thereby mitigating the impact of trade disruptions, including tariffs on electric vehicles from the EU. This approach significantly improves the survival chances of MSEs. In China, where energy costs have surged by 12% since 2020, the introduction of ¥500 billion in green loans could potentially save these enterprises ¥150 billion each year, thereby improving their cash flow. However, challenges persist, such as the pressure of loan repayments, with default rates on green loans reaching 5% in 2023. To address this issue, it is essential to implement flexible repayment terms, such as five-year grace periods, to ensure the sustainability of these enterprises.

Green financing enhances the competitiveness of MSEs by promoting sustainable innovation. In Germany, subsidies for research and development in clean technology, such as 20% tax credits, have resulted in a 12% increase in patents among small firms since 2018. Similarly, in China, MSEs involved in EV components, supported by ¥300 billion in green bonds, have experienced an 18% rise in exports. This approach significantly boosts the innovation capabilities of MSEs. Although Chinese MSEs have historically lagged behind SOEs in research and development, they have the potential to utilize ¥400 billion in green grants to enhance clean technology production by 20% by 2030. However, there are risks associated with misallocation, as evidenced by ¥100 billion invested in unsuccessful hydrogen projects, highlighting the need for performance-based funding to optimize returns.

Green financing promotes inclusivity for MSEs by focusing on regions and demographics that are often overlooked. For instance, rural businesses that implement biogas solutions, supported by India's $1 billion green fund, experienced a 15% increase in employment. This approach aligns the advancement of MSEs with equity objectives. In China, addressing the urban-rural divide through green financing has the potential to create an additional 1 million jobs by 2028. Nevertheless, the current urban bias, with 70% of funding directed towards cities, necessitates a redistribution of resources to foster equitable growth [163].

So, under green and sustainable financing are useful for development MSEs and as result we could give some proposals for China. *(1) Green Loan Expansion* – to increase the availability of green loans to ¥1 trillion by 2027 for MSEs, offering interest rates of 2% to reduce energy expenses by 15% and enhance production by 10%. This initiative will be financed through re-lending quotas from the People's Bank of China. *(2) Sustainable R&D Grants* – to allocate ¥300 billion in grants from 2025 to 2030 to support MSEs involved in renewable energy and EVs, with the goal of achieving a 20% increase in patent registrations and generating ¥500 billion in export revenue. These grants will be linked to metrics for carbon reduction. *(3) Rural Green Bonds* – to plan to issue ¥400 billion in bonds by 2028 to support rural MSEs engaged in organic agriculture and biogas production, with the objective of generating ¥300 billion in revenue and creating 800,000 jobs, in alignment with rural revitalization efforts.

Green and sustainable financing can revolutionize MSE development by driving growth, resilience, competitiveness, and inclusion, though it demands accessible terms and equitable distribution. For China, where MSEs anchor 60% of GDP and green goals loom large, proposals like loan expansion, R&D grants, and rural bonds could unlock ¥1.2 trillion in value by 2030, aligning economic and environmental priorities. Policy must ensure affordability, innovation focus, and rural reach to maximize impact. In 2025, as China advances its green agenda, sustainable financing will be pivotal to MSE prosperity [100].

*Access to Finance*. The availability of financial resources, including affordable loans, grants, and equity, is essential for the development of micro, small, and medium-sized enterprises, as it fosters growth, resilience, and innovation. In China, MSEs are able to secure only 40% of bank loans due to stringent collateral requirements. Access to financing is essential for the growth of MSEs, as it enables investment in essential areas such as equipment, inventory, and market expansion. Lower interest loans such as those at 3% compared to the prevailing market rates of 6% can increase revenue for small businesses by 15-20%, as demonstrated by India's credit initiative in 2022. In China, facilitating credit access for rural MSEs, which represent 30% of the sector, has the potential to generate an additional ¥600 billion in revenue by 2028, leveraging domestic demand in line with the “dual circulation” strategy. Nevertheless, the high interest rates (ranging from 5% to 7%) and the preference for state-owned enterprises (with 70% of bank loans directed towards them) hinder access to financing. To fully realize growth potential, it is necessary to lower these barriers and implement targeted funding strategies.

Access to finance strengthens the resilience of MSEs by providing a buffer for cash flow during challenging times. For instance, the U.S. Paycheck Protection Program allocated $800 billion in 2020, which helped prevent the closure of 50% of small businesses. In China, a relief package worth ¥500 billion in 2022 safeguarded 1.5 million MSE jobs in the aftermath of COVID-19, while deferred payment options reduced default rates by 10%. In China, where 20% of MSEs ceased operations during the lockdowns of 2022, an additional ¥800 billion in revolving credit could potentially stabilize 2 million firms by 2027. However, challenges persist, including repayment risks, as default rates reached 6% in 2023. This situation underscores the need for flexible repayment terms, such as three-year moratoriums, and the importance of risk-sharing arrangements with financial institutions [32].

Access to financing enhances the competitiveness of MSEs by facilitating innovation and the adoption of new technologies. For instance, equity investments, such as the $1 billion allocated to UK venture capital, have resulted in an 18% increase in research and development among small firms since 2018. In China, fintech loans amounting to ¥300 billion have driven a 15% rise in the digital transformation of MSEs, with companies like those in Shenzhen experiencing a doubling of their exports. This financial support is crucial for MSE growth, as it helps to bridge the innovation gap with SOEs. China has the potential to allocate ¥500 billion in innovation loans, which could lead to a 20% increase in MSE patents by 2030, in line with its objectives for technological self-sufficiency. However, there are risks associated with misallocation, as evidenced by ¥150 billion invested in unsuccessful tech ventures, highlighting the need for performance metrics, such as export targets, to ensure that funding has a meaningful impact.

Access to finance promotes inclusivity among MSEs by aiding marginalized communities. In Bangladesh, microfinance has contributed $5 billion since 2015, resulting in a 25% increase in incomes for rural MSEs. Similarly, a microloan initiative in China, launched in 2023 with a budget of ¥200 billion, has generated 600,000 new jobs. Addressing the financial disparity between urban and rural areas in China could potentially create 1 million jobs by 2028. Nevertheless, an urban-centric approach where 70% of loans are directed towards cities along with the requirement for high collateral (150% of the loan amount) limits access for many individuals. This situation necessitates a shift in policies towards providing guarantees and enhancing outreach to rural areas [18].

So, under access to finance are useful for development MSEs and as result we could give some proposals for China. *(1) Low-Cost Loan Program* – to increase the availability of ¥1.5 trillion in 3% loans for MSEs with revenues below ¥10 million by 2027, with the goal of achieving a 15% growth in output and generating ¥800 billion in revenue. This initiative will be financed through re-lending by the People's Bank of China and dividends from state-owned enterprises. *(2) Innovation Equity Fund* – to establish a ¥400 billion venture capital fund dedicated to supporting MSEs in the technology and green sectors from 2025 to 2030, with objectives of achieving a 20% increase in exports and creating 500,000 jobs. To collaborate with private fintech companies such as Ant Group. (*3) Rural Microfinance Boost* – to expand microloan offerings to reach ¥300 billion by 2028 for rural and women-led MSEs, providing 50% guarantees. This initiative aims to contribute an additional ¥400 billion in revenue and create 800,000 jobs, aligning with efforts for rural revitalization. Access to finance can transform MSE development by enabling growth, stability, competitiveness, and inclusion, though it requires affordable terms and equitable reach. Policy must prioritize affordability, innovation, and rural access to maximize benefits. In 2025, as China refines its MSE support, finance access will be key to their prosperity [162].

### 3.2. Fiscal policy transformation and development under global economic crisis

In light of these circumstances, it is imperative for governments to formulate fiscal policy strategies that effectively tackle their fiscal and economic weaknesses. Many nations will need to engage in fiscal consolidation, which begins with the assessment of sustainable fiscal space this involves evaluating whether the forecasts for revenues, expenditures, and interest rates align with the requirements for servicing debt. A comprehensive analysis of contingent liabilities is required, which encompasses government guarantees provided to both state-owned enterprises and private sector organizations. It is vital to produce precise projections of significant economic indicators, including gross domestic product (GDP), inflation rates, trade balances, exchange rates, interest rates, and oil prices, as these factors play a crucial role in influencing expected revenue and expenditures.

This data can subsequently inform the establishment of fiscal objectives. In instances where debt trajectories appear unsustainable, it is imperative for fiscal authorities to identify a viable debt threshold and ascertain the pace at which fiscal consolidation should occur to achieve this target. This process involves: (a) establishing objectives for enhanced revenue generation as part of a medium-term revenue framework; (b) either stabilizing or curtailing expenditures within a medium-term expenditure plan; (c) reforming or establishing binding fiscal regulations, such as a cap on public deficits or a limit on the growth of expenditures; and (d) developing a medium-term debt strategy that tackles risk exposures, reduces macro-financial vulnerabilities, and enhances fiscal policy. The development of such a fiscal strategy should occur in collaboration with other governmental departments and diverse stakeholders to foster societal acceptance of the necessary sacrifices [164].

Achieving the appropriate balance in fiscal policy is of paramount importance. An excessively gradual approach to fiscal consolidation can expose nations to an increased likelihood of sovereign debt crises, potential long-term declines in economic output, heightened levels of poverty, and escalating political and social instability. Conversely, the restoration of fiscal buffers is essential for providing countries with the necessary fiscal flexibility to respond effectively to future crises. In an environment characterized by significant uncertainty, these fiscal buffers serve as vital protective measures. On the other hand, countries that pursue rapid fiscal consolidation may encounter the phenomenon of "self-defeating" fiscal policies. This occurs when the adverse effects of a fiscal contraction are substantial enough to diminish economic output not only in the short term but also in the medium and potentially long term, thereby undermining fiscal consolidation efforts by increasing debt-to-GDP ratios and decreasing tax revenues.

Policymakers can be guided by four key principles when developing their strategies:

(1) ensure that immediate actions are consistent with goals of inclusive and sustainable growth;

(2) optimize the efficiency and impact of fiscal expenditures and revenue generation;

(3) reduce distortions that may hinder economic growth;

(4) foster an equitable distribution of the burdens associated with adjustments.

The are several ways that can assist nations in formulating an effective strategy to address various adverse shocks [10; 165].

*Economy for crisis mitigation strategies.* Key elements for developing fiscally sustainable response strategies include: (a) affordability, which refers to the degree to which the measure affects fiscal stability; (b) predictability and cost control, which involves the capacity to establish upper limits on program costs and to make reasonable forecasts of expenses; (c) targeting, which focuses on restricting benefits to particular businesses, demographic groups, or activities; (d) resistance to misuse, aimed at minimizing leakages; and (e) reversibility, which pertains to the simplicity with which the response could be retracted when needed, without causing economic or behavioural distortions.

*Focus on prioritization and minimize the number of multiplicity measures.* In contexts where robust social protection frameworks are in place, it is generally more effective to enhance current benefits for households on a temporary basis. Conversely, in the absence of such systems, concentrating efforts on a specific priority can mitigate administrative challenges and improve targeting accuracy. For numerous emerging markets and developing economies (EMDEs), this priority may center around ensuring food security (see fig. 3.3).

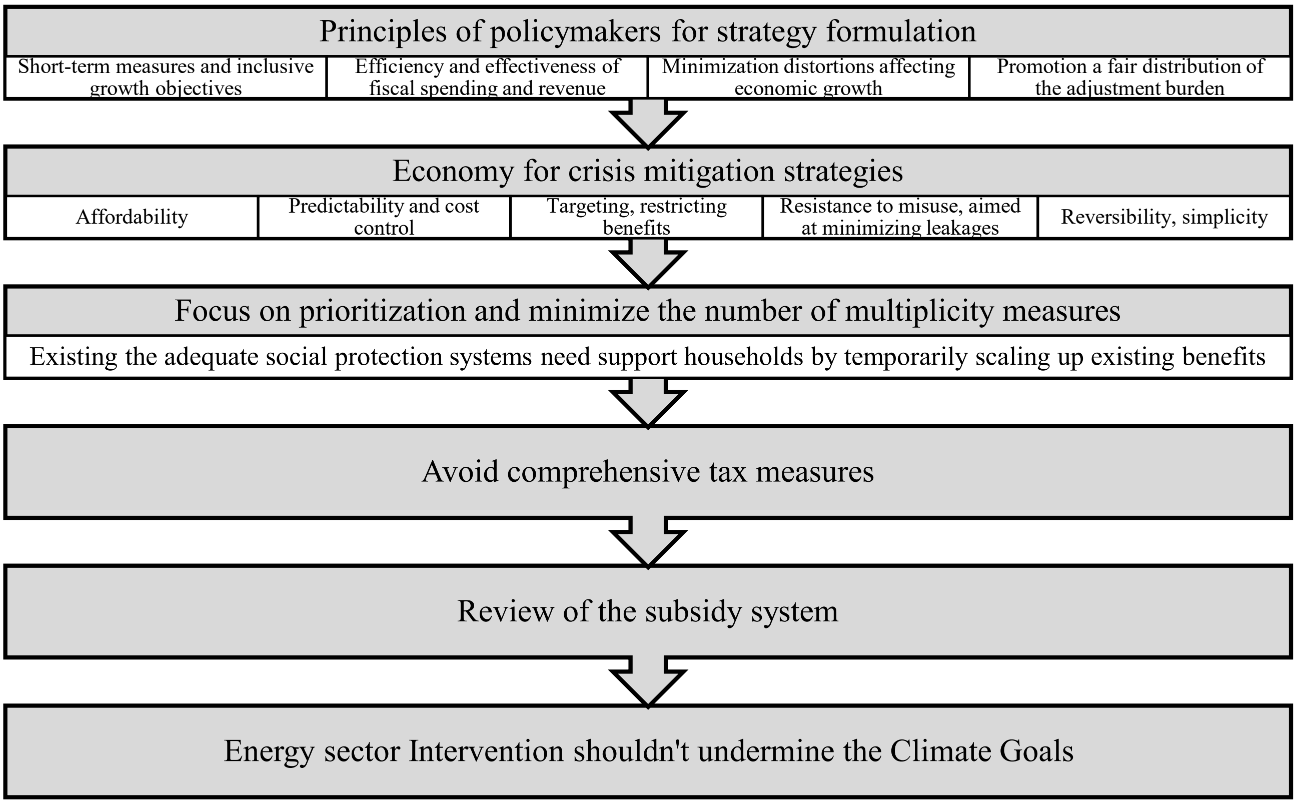


**Fig. 3.3. Fiscal policy transformation under global economic crisis**

Source: [Author]

*Avoid comprehensive tax measures.* It is often difficult to target broad tax measures including reducing tax rates and tax exemptions. The increase in taxes is immediately reflected in the increase in consumer prices, while the decrease in taxes does not reduce prices (as long as the administrative capacity is not too high). Also, when the tax rate is lowered, even if the cut is announced temporarily, political and economic constraints make it difficult to reverse.

*Review of the subsidy system.* Significant price hikes can increase the cost of existing subsidy programs for food, fertilizers and energy, but this is usually not targeted or poorly targeted. To effectively assist the most at-risk populations, governments ought to explore reforms that enhance targeting mechanisms. This involves improving data collection on vulnerable households, individuals, and businesses. It is politically difficult to exclude beneficiaries from the program in an environment where prices are rising, but the government can at least assess a differentiated level of support according to needs.

*Energy sector Intervention shouldn't undermine the Climate Goals.* It is important to take into account the impact on climate targets when considering remedies for high energy prices. (1) Measures to temporarily mitigate from the highest prices could shift to introducing a carbon tax so that carbon prices remain at levels consistent with climate mitigation goals in the medium and long term. (2) Targeted social protection initiatives designed to support vulnerable households dealing with energy price increases are more effective than strategies that simply lower energy prices for consumers. (3) Taxing windfall profits for carbon-based energy producers will diminish the motivation for detrimental investments in carbon-intensive energy sources. (4) It has decreased its reliance on fossil fuel imports by focusing on investments in renewable energy rather than increasing domestic hydrocarbon production. (5) Numerous developing nations, particularly those classified as low-income and vulnerable, may require assistance from the international community to mitigate adverse effects on their economies, households, and businesses [11; 50].

A key takeaway from earlier consolidation initiatives is that the strategies employed were overly concentrated on immediate economic adjustments. It is crucial to incorporate medium-term objectives that aim to enhance productivity growth, address poverty and inequality, strengthen resilience against natural disasters, and facilitate a transition to a low-carbon economy to combat climate change. In fact, the heightened risks associated with climate change vulnerability are expected to substantially increase the interest payments for emerging market and developing economies (EMDEs). Therefore, investments in climate adaptation will not only bolster the resilience of these vulnerable nations to climate-related shocks but also assist in reducing their borrowing expenses [12].

In addition to the dual objectives of curtailing expenditures and enhancing revenues to achieve fiscal targets, fiscal consolidation presents a valuable opportunity to elevate the “quality” of both expenditure and revenue. This “quality” can be assessed through several criteria, including: (1) the allocation of the budget towards sectors and programs that promote developmental goals, such as enhancing productivity and human capital; (2) the efficiency of spending; and (3) the effectiveness of expenditures in fulfilling governmental objectives.

Prioritizing measures that reduce growth distortions is essential. Among various tax types, corporate taxes and personal income taxes are particularly detrimental to economic growth, whereas recurrent taxes on real estate tend to exert minimal negative effects. Raising taxes on carbon emissions has a lesser negative impact on economic growth than increasing personal income taxes (PIT). The imposition of higher PITs is linked to lasting adverse effects on consumption and significant repercussions for employment, while the negative impacts of carbon taxes are relatively minor. Furthermore, carbon taxes can enhance productivity at the firm level by encouraging investments in energy-efficient technologies, which can lead to cost reductions and improvements in both profits and overall productivity [171].

Increasing corporate income tax (CIT) rates could negatively impact economic growth, particularly when existing rates are already deemed reasonable. However, it is essential to focus on reforming ineffective CIT exemptions and tackling tax evasion and avoidance practices among both corporations and individuals. This approach aims to enhance the effective CIT burden on those who are currently under-taxed. Promoting "horizontal equity," which involves taxing businesses with comparable revenues and profits, as well as individuals with similar incomes, in a consistent manner, contributes to a more equitable fiscal policy. This strategy not only generates significant revenue but also diminishes the necessity for tax increases that could hinder growth. Adhering to the such principles significant challenges for any nation, particularly during periods of crisis. The alignment of immediate actions with medium- to long-term goals necessitates a sophisticated approach to policymaking, especially when politicians are under considerable public pressure to deliver immediate results. Despite the extensive discourse surrounding the optimization of efficiency and effectiveness, as well as the reduction of economic growth distortions, the endeavors required to meet these standards extend beyond mere technical tasks. It demands political acumen to strategically implement reforms, adjust objectives to ensure a balance between beneficiaries and those adversely affected, and create a cohesive narrative that galvanizes a diverse coalition of stakeholders in favor of enduring reform. This coalition must also consider the interests of future generations, who currently lack voting rights, as well as those of marginalized communities. Taking into account the above, we offer the following prospects for fiscal policy development (see fig. 3.4)

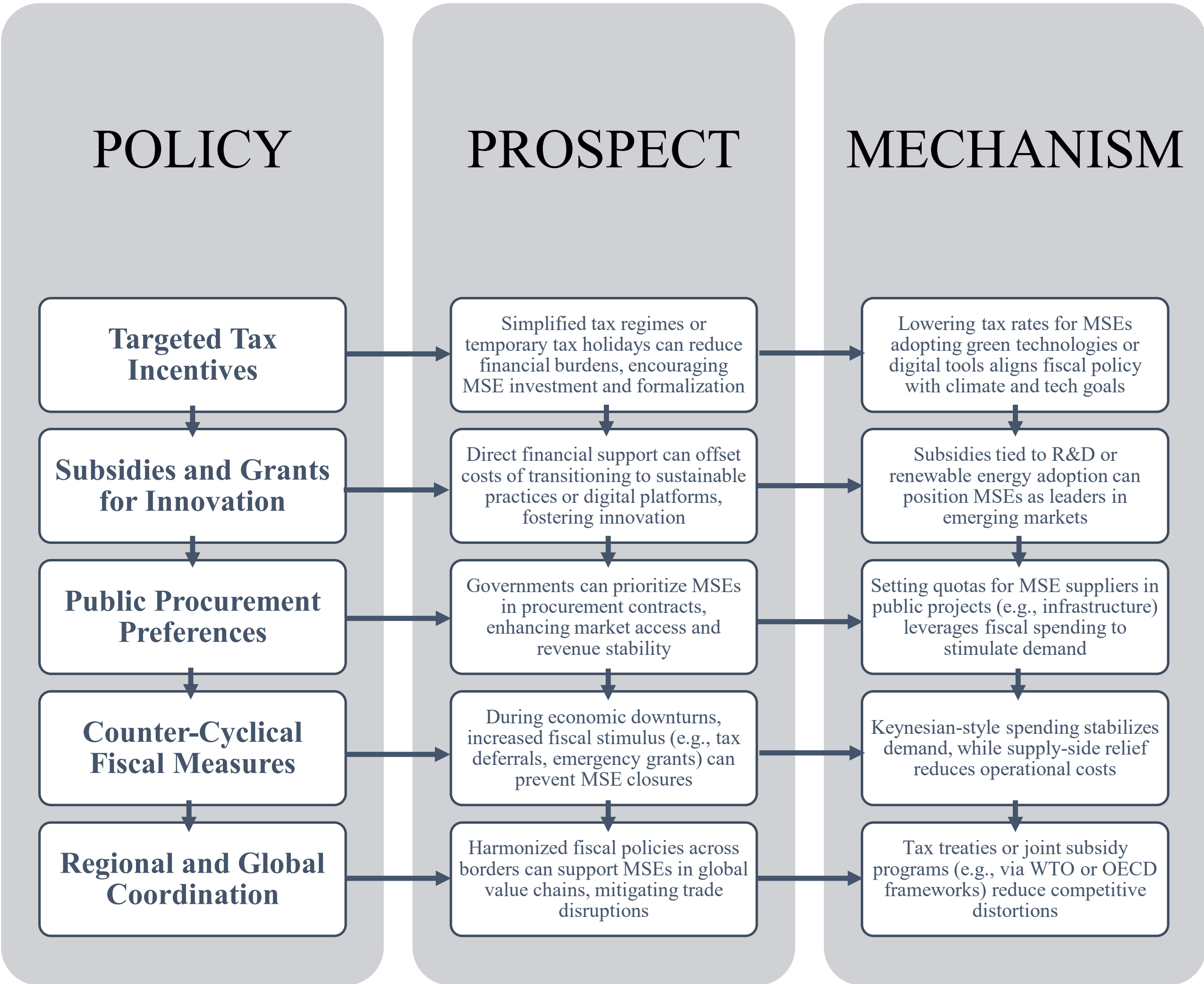


**Fig. 3.4. Prospects for Fiscal Policy Development**

Source: [Author]

*Targeted Tax Incentives.* Targeted tax incentives, which include tax reductions or credits aimed at particular industries, geographic areas, or specific behaviours, serve as effective instruments within the fiscal policy framework. Governments implement these incentives to boost economic activity, tackle social issues, or rectify market inefficiencies. As fiscal policy adapts to contemporary challenges such as inequality, climate change, and technological upheaval, the strategic application of targeted tax incentives can play a crucial role in influencing its progression. Targeted tax incentives have the potential to transform fiscal policy by modifying revenue sources and influencing economic behaviour. For example, providing tax credits to companies in the renewable energy sector promotes investment in sustainable technologies, thereby aligning fiscal policy with environmental objectives. The International Monetary Fund indicates that such incentives within the European Union could lead to a 15% reduction in carbon emissions by 2030, while simultaneously attracting an additional $50 billion in annual investments. However, this approach has its drawbacks: diminished tax revenue may put pressure on public finances, compelling policymakers to either reduce expenditures or increase taxes in other areas. This duality presents a challenge for the development of fiscal policy. While incentives can foster growth in key sectors such as technology or manufacturing there is a risk of short-term fiscal instability if these measures are not accompanied by strategies to enhance revenue. Therefore, policymakers must incorporate incentives into a comprehensive fiscal framework, ensuring that they promote growth without compromising stability [88].

Targeted tax incentives play a significant role in shaping fiscal policy concerning equity and social welfare. By allocating benefits to particular groups, such as low-income families through earned income tax credits or small businesses via tax deductions, governments can help mitigate inequality. Targeted incentives in Nordic nations have contributed to a reduction in the Gini coefficient by 0.05 points since 2015, highlighting their effectiveness in redistributing wealth. Conversely, poorly structured incentives that benefit high-income sectors, such as luxury real estate, can worsen inequality and hinder the progressive objectives of fiscal policy. The distributional effects of these incentives inform the development of fiscal policy by underscoring the importance of precision. It is essential for incentives to be based on data, focusing on sectors that yield measurable social benefits, such as education and healthcare. Over time, this approach could lead to a more inclusive fiscal policy that harmonizes economic growth with social unity, although it necessitates strong evaluation mechanisms to prevent inefficiency or bias.

The introduction of targeted tax incentives presents administrative hurdles that influence the progression of fiscal policy. The complexity escalates as governments create, oversee, and modify these incentives, each necessitating specific eligibility requirements and compliance assessments. The administrative expenses associated with targeted incentives can amount to 5% of their overall value, in contrast to just 1% for broad-based tax reductions. This administrative burden may drive fiscal policy towards digital solutions, with technologies such as AI-enhanced tax systems enhancing efficiency; for instance, Estonia’s e-tax platform has successfully reduced compliance costs by 20%. From a political standpoint, incentives can be a double-edged sword. They enable governments to provide benefits to essential constituencies or sectors, thereby garnering support, but they also risk fostering perceptions of favouritism. In developing nations, where fiscal transparency is frequently lacking, this can undermine public trust and complicate policy reforms. Consequently, the advancement of fiscal policy may depend on improvements in governance implementing transparent targeting and sunset provisions (such as incentives that expire after five years) could alleviate these concerns and promote a more accountable system [20; 165].

Targeted tax incentives present various opportunities for enhancing fiscal policy: (a) innovation – research and development incentives, such as the 20% tax credits available in the UK, can stimulate technological advancement, leading to an increase in taxable income over time. (b) resilience – providing support to industries affected by crises, such as the tourism sector during the COVID-19 pandemic, can help stabilize economies. This was evidenced by Ukraine’s 2022 VAT exemptions for exporters, which resulted in an 8% rise in export revenue despite the ongoing conflict. (c) sustainability – green tax incentives can align fiscal policy with international climate objectives, with the potential to attract $100 billion in private investment each year by 2030. Nonetheless, these advantages are accompanied by certain challenges and risks: (1) revenue decline – excessive reliance on incentives can constrict fiscal resources, thereby restricting funding for public services Italy's €20 billion in tax reductions from 2015 to 2020 led to a 3% decrease in healthcare expenditure. (2) inefficiency – misaligned incentives, such as subsidies for fossil fuels, can entrench obsolete industries, hindering necessary structural reforms. (3) complexity – disjointed tax systems may discourage investment, as evidenced in India, where overlapping incentives increased compliance costs by 15%.

Targeted tax incentives possess the capacity to significantly influence the development of fiscal policy, providing mechanisms to promote growth, equity, and sustainability. These incentives can guide economies towards innovation and resilience; however, their effectiveness relies on meticulous design that balances revenue implications, guarantees fairness, and simplifies administration. In nations such as Ukraine, which are grappling with the challenges of war and recovery, these incentives could enhance export industries and draw in investments, but they must be implemented alongside strong fiscal discipline. As fiscal policy continues to evolve, targeted incentives are expected to assume a pivotal role, necessitating that policymakers refine their parameters and governance to optimize advantages while mitigating risks [3; 20].

*Subsidies and Grants for Innovation.* Financial incentives such as subsidies and grants for innovation serve as essential tools aimed at promoting research, development, and technological progress by alleviating financial obstacles for companies, start-ups, and research organizations. Governments across the globe utilize these mechanisms to encourage economic expansion, improve competitiveness, and tackle societal issues such as climate change and healthcare. As fiscal policies evolve in response to a swiftly changing global environment, these subsidies and grants can significantly impact development by transforming revenue distribution, economic priorities, and the sustainability of fiscal policies in the long run. Subsidies and grants aimed at fostering innovation can play a crucial role in enhancing the effectiveness of fiscal policy in promoting economic growth. By investing in research and development (R&D), governments can encourage technological advancements that increase productive capacity and establish high-value industries. For instance, every dollar allocated to R&D subsidies yields an impressive four dollars in economic output over a ten-year period. This is exemplified by South Korea's $10 billion innovation grants initiated in 2015, which have contributed to an annual GDP growth of 1.2%. Similarly, the European Union's Horizon Europe program, with a budget of €95.5 billion for the period from 2021 to 2027, has resulted in a 3% annual increase in employment within the technology sector.

This evidence suggests that fiscal policy should pivot towards long-term investment approaches. Innovation subsidies have the potential to expand the tax base over time, as emerging industries generate taxable income that can help offset initial expenditures. Nevertheless, the time lag between investment and returns typically ranging from five to ten years demands fiscal patience, presenting a challenge for policymakers who must reconcile immediate budgetary requirements with anticipated future benefits. Consequently, this may encourage a shift in fiscal policy towards multi-year planning frameworks, positioning innovation as a fundamental driver of growth. Subsidies and grants play a crucial role in driving innovation, yet they also place significant pressure on fiscal resources, leading to difficult choices in policy formulation. Direct financial support can limit the funds available for other essential areas such as healthcare and education. This dynamic influences the development of fiscal policy, requiring governments to establish clear priorities. As a result, there may be a growing emphasis on cost-benefit analyses to validate subsidies, with a preference for sectors that demonstrate substantial impact, such as green technology over traditional industries. Alternatively, fiscal policy might shift towards hybrid funding approaches, including public-private partnerships (PPPs) or repayable grants, which could alleviate budgetary pressures while promoting innovation. Nonetheless, there is a risk of excessive subsidization, where financial support sustains non-viable projects, ultimately depleting resources without yielding returns, as evidenced by certain solar initiatives in the EU during the 2010s [74].

Support in the form of subsidies and grants for innovation significantly affects the social aspects of fiscal policy. By promoting job creation in advanced sectors such as artificial intelligence, biotechnology, and renewable energy, these initiatives help tackle unemployment and address skill shortages. This social influence encourages fiscal policy to adopt a dual-focused approach that balances economic growth with welfare considerations. Subsidies serve not only as instruments for economic expansion but also as means to promote equity, particularly in underserved areas or among specific demographics, such as rural start-ups. However, achieving this requires precise targeting to prevent inefficiencies; broad subsidies may overlook vulnerable populations, while overly specific ones could introduce political biases, necessitating a refinement of fiscal policy's distribution methods. The management of subsidies and grants aimed at fostering innovation necessitates strong governance, which in turn affects the operational framework of fiscal policy. Unlike broad tax reductions, these financial instruments require meticulous oversight, including application procedures, monitoring of progress, and assessment of outcomes. From a political standpoint, subsidies can lead to disputes – favouring specific sectors, such as technology over manufacturing, may create divisions among stakeholders, as evidenced by the discussions surrounding the CHIPS Act in the United States. Consequently, the development of fiscal policy may increasingly emphasize transparency through mechanisms like public dashboards or independent audits to uphold public trust. In contexts with weaker governance, such as post-conflict nations, the threat of corruption is significant, necessitating more stringent controls that could reshape standards of fiscal accountability [171].

So, subsidies and grants aimed at innovation have the potential to significantly reshape the development of fiscal policy by promoting growth, resilience, and social benefits; however, they require meticulous adjustment. These financial tools encourage a shift in fiscal policy towards a long-term perspective, precise targeting, and digital governance, while also presenting challenges in managing trade-offs and associated risks. In the context of country, which is navigating recovery, such instruments could revitalize export sectors and draw in investments, contingent upon the maintenance of fiscal discipline and transparency. As fiscal policy continues to evolve, funding for innovation is expected to become a fundamental element, striking a balance between immediate expenditures and transformative opportunities.

*Public Procurement Preferences.* Public procurement preferences – policies that favour certain suppliers, including local companies, small enterprises, or environmentally sustainable producers, in government acquisitions act as a strategic tool for fiscal policy. By channelling significant public expenditure (typically 10-15% of global GDP) towards specific economic or social objectives, these preferences can transform the function of fiscal policy in promoting growth, equity, and sustainability. Public procurement preferences can enhance fiscal policy by directing resources to key sectors, thereby improving economic performance and fiscal stability. By prioritizing domestic companies, governments can stimulate local production, create jobs, and increase tax revenues. According to the OECD (2024), reallocating 10% of procurement spending to domestic suppliers could result in a GDP increase of 0.5-1% in developed nations. In China, the suggested 20% price advantage for locally manufactured industrial products could benefit major manufacturers such as CRRC and BYD, helping to mitigate global trade challenges, such as the EU's tariffs on Chinese electric vehicles (EVs) in 2024. This approach is consistent with China's "dual circulation" strategy, which focuses on boosting domestic demand. For the advancement of fiscal policy, this indicates a need for integrating industrial policy. Such preferences could anchor fiscal stimulus in rapidly growing sectors like green technology or semiconductors, thereby broadening the tax base over the long term. However, excessive dependence on domestic firms may lead to inefficiencies; subsidizing non-competitive producers could drive up costs, as evidenced by India's procurement practices, which increased project costs by 15%. China could address this issue by linking preferences to performance indicators, such as innovation output, ensuring that fiscal investments enhance productivity rather than merely fostering protectionism [3].

While promoting growth, procurement preferences can place significant pressure on fiscal budgets, leading to complex policy trade-offs. Prioritizing more expensive domestic suppliers over less costly imports can limit fiscal flexibility; for instance, if China's 20% preference is fully enacted, it could result in an annual increase in procurement expenses by ¥800 billion. Given that local government debt in

China reached 116% of GDP in 2023, this situation could intensify fiscal challenges, particularly in light of the ¥10 trillion in bond swaps required for recovery efforts post-2022. Consequently, the development of fiscal policy may shift towards enhancing efficiency and optimizing revenue. China might mitigate these costs by combining procurement preferences with VAT rebates for compliant businesses, similar to the measures in the 2023 tax relief initiative. Another approach could involve directing preferences towards micro, small, and medium-sized enterprises, which account for 80% of urban employment, thereby increasing taxable income without necessitating extensive subsidies. However, there is a risk of creating fiscal distortions; excessive funding for favoured sectors could detract from essential services like education and healthcare, highlighting the need for multi-year budgeting to reconcile immediate expenses with future benefits.

Procurement preferences can effectively integrate fiscal policy with social and environmental goals, thereby broadening its developmental impact. By prioritizing environmentally friendly suppliers, such as solar panel manufacturers, China can advance its 2060 carbon neutrality target, potentially achieving a 2% annual reduction in emissions if 30% of procurement is redirected towards low-carbon products. Additionally, favouring MSEs or businesses in rural areas could help mitigate regional inequalities, which is crucial in a nation where coastal provinces exceed inland regions by 50% in GDP per capita. This approach reorients fiscal policy towards a framework that balances sustainability and equity. China's recent focus on "high-quality growth" aligns with this vision, suggesting that procurement can serve as a mechanism for fostering social stability in addition to driving economic performance. Nevertheless, challenges in implementation remain: green procurement preferences might inadvertently benefit large state-owned enterprises (SOEs) at the expense of smaller, innovative firms, while quotas for MSEs could lead to superficial compliance without genuine capacity enhancement. Therefore, fiscal policy must adapt to incorporate impact assessments, ensuring that procurement preferences yield tangible and measurable results [42].

Preferences complicate the management of fiscal policy, necessitating governance reforms. The process of defining “domestic” goods such as mandating that essential production phases occur in China requires thorough verification, which can increase administrative expenses by 3-5%. The fragmented nature of China’s procurement system, divided between central and local authorities, exacerbates this issue; local governments may show favouritism towards allies, as evidenced by previous public-private partnership scandals. Consequently, the development of fiscal policy should emphasize transparency and digitalization. China’s e-procurement platforms, like the China Government Procurement Network, could leverage artificial intelligence to monitor compliance, potentially reducing corruption risks by 20%, similar to the outcomes observed in Estonia. From a political standpoint, preferences may lead to trade conflicts, as U.S. companies have already expressed concerns regarding China’s bias towards indigenous innovation. Therefore, fiscal policy may require diplomatic coordination to balance domestic interests with international relations [6; 42].

Public procurement preferences have the potential to reshape the development of fiscal policy by promoting growth, sustainability, and equity; however, they require meticulous adjustment. For China, these preferences serve as a mechanism to address trade conflicts, aid in recovery, and achieve strategic objectives, although challenges such as fiscal pressure and inefficiency are present. Initiatives focused on green technology, micro, small and micro-sized enterprises, and performance evaluation could enhance results, steering fiscal policy towards a more dynamic and outcome-oriented framework. As China updates its procurement standards in 2025, the strategic integration of these preferences will be crucial for balancing short-term expenses with long-term fiscal stability.

*Counter-Cyclical Fiscal Measures*. Counter-cyclical fiscal policies, which involve increasing government expenditure or implementing tax reductions during economic recessions while exercising restraint during periods of economic expansion, are designed to stabilize economies by moderating business cycles. These strategies, grounded in Keynesian economic theory, have become increasingly significant in response to global crises, including the 2008 financial crisis and China's recovery from COVID-19 in 2022. In China, fiscal stimulus is projected to reach ¥10 trillion ($1.4 trillion) through bond swaps by the end of 2024 to address decelerating growth, suggesting that counter-cyclical measures may play a pivotal role in shaping the future of fiscal policy. Counter-cyclical fiscal measures play a crucial role in enhancing the stabilizing effects of fiscal policy by reducing economic fluctuations. In times of economic decline, increased government expenditure, such as on infrastructure initiatives, stimulates demand, while tax reductions encourage higher household spending. This approach reinforces the counter-cyclical objective of fiscal policy development. In China, focusing on struggling sectors like real estate, which constitutes 20% of GDP and has experienced a 30% decline in sales since 2021, could potentially revive growth to a range of 5-6% by 2026. However, the success of these measures is contingent upon timely implementation; for instance, the EU's 2020 COVID relief package demonstrated that delayed actions can diminish effectiveness by 20%. Consequently, fiscal policy may need to adapt towards rapid-response strategies that utilize real-time data to enhance the efficacy of interventions [101].

While these measures aim to stabilize the economy, they pose significant challenges to fiscal sustainability, which is a pressing issue for China's heavily indebted economy. In 2023, local government debt reached ¥90 trillion, equivalent to 116% of GDP, exacerbated by counter-cyclical bond issuances, including a ¥10 trillion swap planned for 2024. The World Bank cautions that ongoing deficits averaging 6% of GDP since 2020 are likely to increase borrowing costs, with 10-year bond yields projected to rise from 2.1% in 2022 to 2.5% in 2024. This situation compels fiscal policy to navigate a delicate balance. While counter-cyclical spending may temporarily increase deficits, it has the potential to enhance revenue in the long run through economic growth; for instance, China's 2009 stimulus recovered 70% of its costs through tax revenues by 2015. Strategies such as temporary VAT reductions could help mitigate debt growth, and implementing fiscal rules, such as a 3% deficit cap during economic upswings, could aid in rebuilding financial buffers. However, without strict fiscal discipline, there is a risk of overextending policy measures, which could entrench China in a high-debt path that limits future economic flexibility.

Counter-cyclical measures enhance the social function of fiscal policy by safeguarding jobs and incomes during times of crisis. Initiatives such as public works or subsidies illustrated by China's ¥500 billion relief for MSEs in 2022 help alleviate unemployment, which rose to 6% in urban areas following the COVID pandemic. On average, every $1 billion spent on counter-cyclical measures preserves approximately 50,000 jobs, as demonstrated by Germany's Kurzarbeit program in 2020. In China, where 80% of urban employment is linked to MSEs, this approach strengthens the resilience aspect of fiscal policy. Focusing on at-risk populations such as rural migrants or youth, who faced a 20% unemployment rate in 2023 could help mitigate social unrest, a significant concern following the protests of 2022. Consequently, the evolution of fiscal policy may incorporate social safety nets, like wage subsidies, within counter-cyclical strategies. However, caution is warranted regarding overfunding, which could lead to dependency, thus necessitating the implementation of sunset clauses, such as two-year limits [155].

The implementation of counter-cyclical measures necessitates agile institutions and a reconfiguration of fiscal policy governance. Swift expenditure demands effective coordination; for instance, China's 2024 stimulus plan involved 31 provinces, revealing delays as local approvals lagged by three months. During such spending surges, administrative costs typically increase by 2-4%, prompting a shift towards digital tools in fiscal policy China's e-budget system successfully reduced delays by 15% in 2023. From a political standpoint, these measures are subject to criticism, particularly regarding the preference for state-owned enterprises over private companies, with 70% of the 2024 funds allocated to SOEs, which raises concerns about potential inefficiencies reminiscent of the state-dominated stimulus of 2009. Fiscal policy may progress towards greater transparency, potentially incorporating public dashboards or independent audits, especially as China navigates its domestic priorities alongside global perceptions in the context of U.S. competition. However, inadequate execution could jeopardize credibility, necessitating institutional reforms.

Counter-cyclical fiscal strategies have the potential to transform the development of fiscal policy by promoting stability, resilience, and growth, although they also pose challenges to sustainability and governance. For China, which is currently grappling with decelerating growth and significant debt levels, these strategies present a crucial opportunity. Initiatives such as increased infrastructure investment, support for micro, small, and medium enterprises, and the establishment of reserve funds could help maintain a growth rate of 5% until 2030 while effectively managing associated risks. It is essential for fiscal policy to adapt by prioritizing agility, discipline, and inclusivity, ensuring a balance between immediate assistance and long-term sustainability. As China faces economic challenges in 2025, the implementation of counter-cyclical measures will be essential in fostering a resilient fiscal future.

*Regional and Global Coordination*. Coordinating fiscal policy at both regional and global levels via agreements, collaborative financing, or harmonized tax and expenditure strategies strengthens governments' capacity to tackle transnational issues such as trade deficits, climate change, and economic downturns. For China, which stands as the world's second-largest economy with a GDP of $18 trillion in 2023 and plays a significant role in initiatives like the Belt and Road Initiative (BRI), such coordination has the potential to transform the development of fiscal policies. As China faces challenges related to decelerating growth and increasing debt, this coordination presents both opportunities and challenges. Coordination can enhance fiscal policy by consolidating resources and harmonizing priorities across nations. Regional initiatives, such as the European Union's €750 billion NextGenerationEU fund (2021-2026), significantly increase the fiscal capabilities of individual countries; for instance, Germany's €25 billion allocation contributed to a 1.2% annual increase in its GDP. On a global scale, bailouts led by the IMF, like Argentina's $44 billion assistance in 2022, help stabilize economies and maintain fiscal flexibility. For China, collaborating with ASEAN through the Regional Comprehensive Economic Partnership (RCEP) could optimize ¥1 trillion in annual trade-related expenditures, resulting in a 10% reduction in logistics costs. This approach fosters an evolution in fiscal policy development that emphasizes efficiency. China could utilize the $1 trillion infrastructure network of the

Belt and Road Initiative (BRI) to co-finance projects, such as those in Central Asia, thereby alleviating its individual financial burden and enhancing returns through shared toll revenues. Nevertheless, differing priorities such as BRI partners prioritizing immediate profits pose a risk of inefficiency, necessitating a shift towards harmonized standards and collaborative oversight mechanisms in fiscal policy [19; 161].

Coordination plays a vital role in reducing economic spillovers, which is essential for maintaining fiscal policy stability. Uncoordinated stimulus efforts, such as China's ¥10 trillion bond swap planned for 2024, have the potential to drive up global commodity prices, thereby destabilizing neighbouring economies. In contrast, the G20's coordinated response to COVID-19, amounting to $14 trillion in 2020, resulted in synchronized spending that contributed to a 2% increase in global GDP. For China, aligning its fiscal expansion with partners in the Regional Comprehensive Economic Partnership (RCEP) could help stabilize regional supply chains, especially as exports to Asia reached ¥6 trillion in 2023. This alignment reinforces the stabilizing function of fiscal policy. China's counter-cyclical initiatives, such as a ¥2 trillion investment in infrastructure in 2024, could be coordinated with ASEAN or Belt and Road Initiative (BRI) countries, enhancing their effectiveness while minimizing inflationary spillovers. However, tensions regarding sovereignty may arise, as partners could be wary of China's influence, particularly in discussions surrounding the BRI debt trap. Consequently, fiscal policy may need to adapt towards more flexible, consensus-driven frameworks that balance influence with collaborative efforts.

Regional and global collaboration has the potential to revolutionize the formulation of fiscal policies by improving efficiency, stability, and sustainability, albeit at the cost of some autonomy and governance. For China, utilizing platforms such as RCEP, BRI, and AIIB can provide significant fiscal benefits through initiatives like a fiscal agreement, a green fund, and tax incentives. It is essential for fiscal policy to progress towards cooperative frameworks that reconcile domestic priorities with international responsibilities. As China strengthens its economic position in 2025, effective coordination will be crucial for ensuring a robust fiscal future.

### 3.3. Fiscal policy model for the development of micro and small enterprises

Micro, small, and medium enterprises play a crucial role in fostering global economic growth, driving innovation, and generating employment opportunities. Legislative measures and international initiatives are necessary to tackle the obstacles encountered by MSEs and to cultivate a supportive environment for their development. By adopting digital technologies, sustainable methods, and inclusive financial solutions, MSEs can realize their full capabilities and make substantial contributions to a robust and thriving global economy. Ongoing assistance from governments, international bodies, and the private sector will be vital for the continued success and sustainability of MSEs in the future. International organizations are essential in aiding micro, small, and medium enterprises worldwide. The World Bank Group offers both financial and technical support to MSEs in developing nations, prioritizing access to finance, market opportunities, and skill enhancement. The International Trade Centre (ITC) promotes the involvement of MSEs in global trade by providing market insights and capacity development. Additionally, the United Nations' Sustainable Development Goals (SDGs) highlight the vital role of MSEs in fostering inclusive and sustainable economic growth [166].

The outlook for MSEs is optimistic, bolstered by ongoing global initiatives and advancements in technology. The growing integration of digital technologies is set to boost productivity, expand market reach, and enhance competitiveness for these enterprises. A focus on sustainability will be essential as MSEs implement eco-friendly practices to comply with regulatory requirements and satisfy consumer demands. Furthermore, innovations in financial services, such as FinTech and alternative lending options, will facilitate better access to funding for MSEs. Enhancing their involvement in global supply chains will open up new avenues for growth and market expansion for these businesses. Numerous MSE participants that have embraced digital platforms for marketing and distributing their products demonstrate their ability to access a wider market and enhance their sales volume (see fig. 3.5). By leveraging social media, e-commerce, and various digital tools, they can present their offerings to consumers who were once challenging to engage. The process of digitalization also enables MSEs to streamline their operations, accelerate transactions, and boost overall efficiency. Furthermore, through digitalization, businesses gain access to more pertinent market data, allowing them to better comprehend consumer demands and react swiftly.

| I. Resilience Through Diversification | II. Formalization and Scale-Up | III. Job Creation and Inclusion | IV. Technological Leapfrogging |
|---|---|---|---|
| • **Prospect**: Fiscal support for diversifying products/services (e.g., into green or digital markets) reduces reliance on volatile sectors.<br>• **Opportunity**: MSEs can tap into growing demand for sustainable goods, projected to reach $150 billion annually by 2030. | • **Prospect**: Tax incentives and grants can shift informal MSEs into the formal economy, unlocking access to finance and markets.<br>• **Impact**: Formal MSEs tend to grow 20-30% faster than informal peers. | • **Prospect**: Fiscal-backed training programs or hiring subsidies can amplify MSEs' role as job creators, especially for youth and women.<br>• **Potential**: Aligns with SDG 8 (Decent Work), addressing unemployment in crisis-hit regions. | • **Prospect**: Subsidized access to digital tools (e.g., e-commerce platforms) enables MSEs to bypass traditional barriers |

**Fig. 3.5. Prospects for MSE Development**

Source: [Author]

Transforming business models is a crucial strategy for micro, small, and medium enterprises to enhance their resilience and competitive strength in the post-pandemic era. Conceptually, the transformation of MSE business models can be achieved by modifying nine key elements: customer segments, value propositions, channels, customer relationships, revenue streams, key resources, key activities, key partnerships, and cost structures. An adaptive and innovative approach to business model transformation, particularly through the use of digital technology, can significantly bolster the resilience of MSEs in the aftermath of the pandemic. Additionally, it is essential to consider changes in consumer behaviour and needs to ensure business continuity. In emerging economies, microenterprises play a crucial role in supporting livelihoods, making them a significant component of the MSEs sector. As these economies progress and increase their income levels, microenterprises may experience growth in revenue and productivity; however, the majority remain small or medium-sized. Consequently, MSEs collectively continue to make substantial contributions to national output, thereby enhancing overall productivity growth. In contrast, the situation in wealthier economies is different. Employment has largely transitioned from microenterprises to small and micro-sized enterprises, and even larger corporations [166; 168].

Approximately half of all MSE employees work in microenterprises. As these advanced economies advance further, a notable number of MSEs tend to expand into larger entities, be acquired or merged with them, or exit the market altogether in a process referred to as creative destruction. This shift results in an increased contribution of large businesses to the national output of the wealthiest economies, relative to that of smaller firms. Thus, while MSEs may not increase their share of the economy, they continue to play a vital role in fostering business dynamism. Although MSEs play a crucial role in global economies, their productivity is approximately half that of larger enterprises, and closing this gap could yield substantial benefits. However, it is noteworthy that this disparity is not uniform; productivity levels differ significantly across various countries and industries, and even among nations within the same sector.

The international business environment is highly interlinked. The fortunes of major corporations can significantly influence entire economic systems. Therefore, it is essential for stakeholders such as policymakers, regulatory agencies, associations, and large corporations to create favourable conditions that promote the growth and success of all businesses. Achieving these conditions may necessitate actions that extend beyond traditional policies aimed at micro, small, and medium enterprises, such as improving access to financing for MSEs and providing training for their workforce. Furthermore, it may also require the implementation of strategies aimed at enhancing “collective productivity”. Enhancing collaboration and connections between large and small enterprises can lead to increased productivity in areas where both types of businesses can thrive, as well as in sectors where larger firms excel while smaller one’s struggle. In cases where small businesses outperform their larger counterparts, it would be advantageous to support the growth of these smaller firms into larger entities or facilitate mergers to foster business vitality. Conversely, if both large and small companies are underperforming relative to their competitors, more comprehensive measures may be necessary to strengthen the overall economic landscape. This could include investing in both physical and digital infrastructure, creating transparent and equitable regulatory frameworks that encourage competition, lowering trade barriers, and ensuring equitable access to financial resources.

A significant role in regional development is played by the UN initiative titled "Strengthening National Capacities for Enhancing MSE Resilience and Building Forward Better to Accelerate the Implementation of the 2030 Agenda", which was launched in 2022 for developing nations involved in the Belt and Road Initiative. This project is financed by the United Nations Peace and Development Fund. It aims to implement integrated and inclusive policy measures that bolster the resilience of micro, small, and medium enterprises. The initiative enhances the capabilities of policymakers to create and execute effective, demand-driven policies while also empowering MSE entrepreneurs, especially women and youth, to access financial resources, seize high-value market opportunities, and adopt innovative practices. The project fosters collaborations with government entities, Resident Coordinators' Offices, UN Country Teams, and private sector partners, seeking to align with intergovernmental processes and global and regional initiatives. Its goal is to maximize the contribution of MSEs to shared prosperity, inclusive economic growth, sustainable production and consumption, reduction of inequality, and the promotion of solidarity and cooperation among countries in Africa and Asia [42].

Numerous industries have experienced shifts in industrial leadership multiple times due to the rapid advancement of late entrants. Often, established companies struggle to sustain their dominance in production or market share, allowing newcomers to eventually catch up. While the latecomer may initially achieve leadership, they too may later lose it to another emerging competitor. The situation in China's solar thermal energy sector illustrates that rural regions have skipped the reliance on gas or electricity for heating, advancing directly to solar thermal solutions. This scenario highlights that both the supply side (technology) and the alignment or misalignment with demand can drive leapfrogging. For affluent or urban residents, solar water heaters represent a significant disruption to their established lifestyles, whereas underdeveloped areas, lacking such entrenched systems, are more open to adopting alternative energy solutions. Additionally, a relevant example involving Fourth Industrial Revolution (4IR) technologies is Deep Glint, a prominent intelligent IoT technology firm based in Beijing, China. Whether the 4IR presents a new opportunity for leapfrogging or poses additional risks for latecomers largely hinges on a country's preparedness and response, which includes factors such as industrial policy, digital literacy, skill and education levels relative to wage rates, and the size and position of the domestic market within global value chains [18].

MSEs are expected to continue being the primary source of employment in various sectors, including E-commerce and Logistics, which encompasses last-mile delivery, warehouse positions, and live-streaming sales representatives. In the Manufacturing and Light Industry, job opportunities will arise in textiles, electronics assembly, and auto parts production. The Services Sector will see growth in areas such as food and beverage, tourism, elderly care, and repair services. Additionally, jobs in Emerging Technologies and the Gig Economy will include roles in the AI and Digital Economy, such as freelance programmers, data annotators, and AI trainers for tech-focused MSEs. Green Jobs will feature positions like solar panel installers, EV battery recyclers, and energy auditors. Rural E-commerce will create opportunities for Taobao village entrepreneurs, agri-streamers, and cold-chain logistics personnel. Government initiatives aimed at supporting employment will include subsidized hiring through tax incentives for MSEs that employ graduates, veterans, and rural migrants. Vocational training programs funded by the state, such as Alibaba's Rural Taobao training, will focus on upskilling. Furthermore, flexible work policies will promote the formalization of worker benefits within gig economy platforms like Meituan and Didi.

To promote the growth and development of micro and small enterprises, China ought to implement a holistic fiscal policy strategy that increases financial assistance, alleviates burdens, and creates a favourable business climate. Here are key strategies: tax incentives and reductions, direct fiscal subsidies and grants, enhanced access to financing, reduce administrative and operational costs, strengthen market demand for MSEs, regional and sector-specific support, strengthen financial supervision and anti-monopoly measures, digital and green transition support, implementation and monitoring (see fig. 3.6).

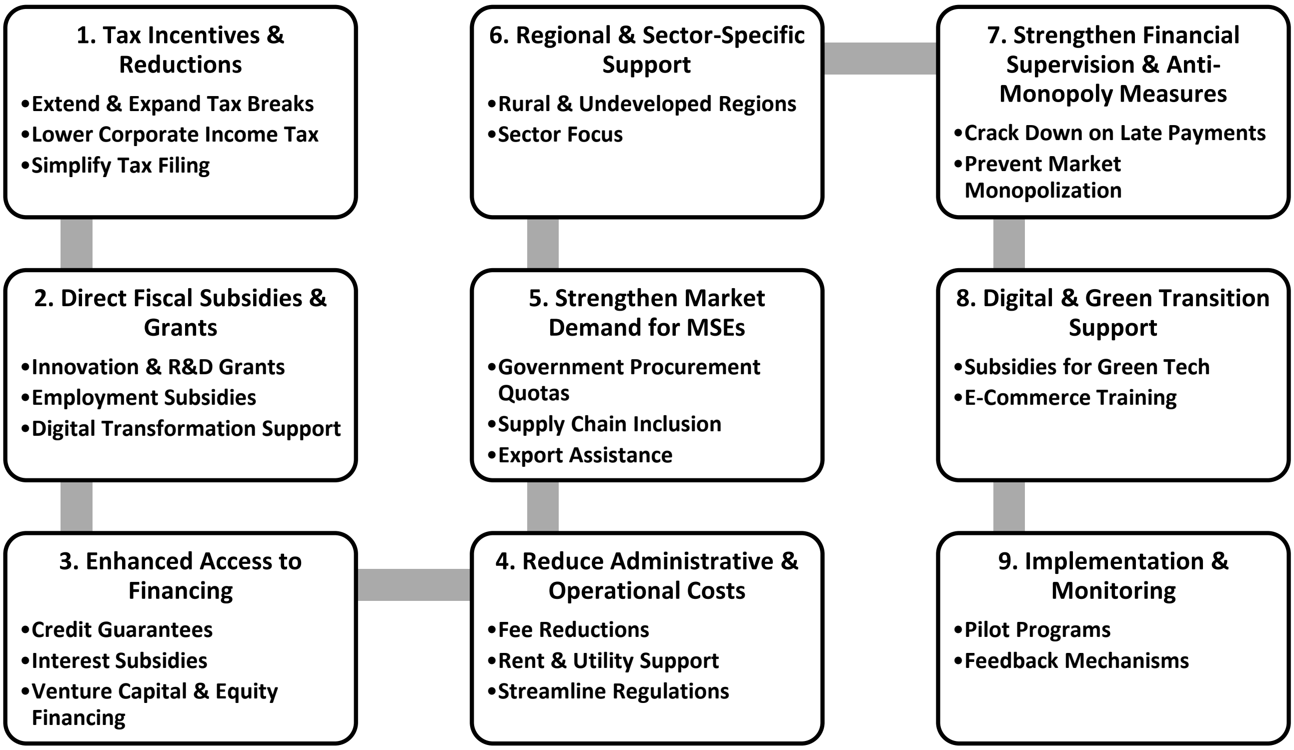


**Fig. 3.6. Fiscal policy adaptation model for development MSEs in China**

Source: [Author]

1. Tax incentives and reductions play a crucial role and encompass the following elements: *(a) extension and expansion of tax breaks:* sustain VAT exemptions or reductions for micro and small enterprises, particularly within the high-tech, green, and service industries; *(b) lower corporate income tax:* preserve favourable tax rates (such as 5-10%) for small businesses that generate annual profits beneath a specified limit; *(c) simplify tax filing:* lower compliance expenses by implementing digital tax systems and optimizing procedures.

2. Direct fiscal subsidies and grants are also significant and encompass the following: *(a) innovation and R&D grants:* these grants offer direct financial support to micro and small enterprises operating in emerging sectors such as artificial

intelligence, clean energy, and biotechnology; *(b) employment subsidies:* these subsidies provide financial assistance in the form of wage support or reductions in social security contributions for the employment of graduates, rural migrants, or individuals who have been laid off; *(c) digital transformation support:* this funding is aimed at assisting MSEs in their adoption of e-commerce, cloud computing, and advanced manufacturing technologies.

3. Enhanced access to financing can be effectively achieved through the following measures: *(a) credit guarantees*: broaden government-supported loan guarantee initiatives to lessen collateral demands; *(b) interest subsidies:* provide partial interest reductions on bank loans for micro and small enterprises operating in key sectors; *(c) venture capital and equity financing:* create state-directed funds aimed at investing in promising start-ups.

4. Reduce administrative and operational costs can be achieved through the following measures: *(a) fee reductions:* eliminate business registration fees, inspection costs, and other administrative charges; *(b) rent and utility support:* offer financial assistance to micro and small enterprises located in industrial zones or facing economic challenges; *(c) streamline regulations:* reduce bureaucratic hurdles by transitioning licensing and permitting procedures to a digital format.

5. Strengthen market demand for MSEs can be achieved through the following measures: *(a) government procurement quotas:* establish a requirement that a minimum percentage (e.g., 30%) of public contracts be allocated to MSEs; *(b) supply chain inclusion:* motivate large state-owned enterprises and private companies to procure from MSEs by providing tax incentives; *(c) export assistance:* Increase export rebates and provide waivers on customs fees for MSEs engaged in cross-border e-commerce.

6. Regional and sector-specific support is crucial and can be implemented through the following measures: *(a) rural and undeveloped regions:* enhance fiscal transfers to local authorities to assist micro and small enterprises in these less-developed regions; *(b) sector focus:* direct policies towards labour-intensive industries, such as textiles and food processing, as well as technology-driven sectors.

7. Strengthen financial supervision & anti-monopoly measures is crucial and can be achieved through the following actions: *(a) crack down on late payments:* implement more stringent penalties for large corporations that postpone payments to micro and small enterprises supplying goods and services; (b) *prevent market monopolization:* guarantee that MSEs receive equitable access to various platforms, such as e-commerce and logistics services.

8. Digital and green transitions support can positively impact overall results and can be implemented through the following measures: *(a) subsidies for green technology:* encourage micro and small enterprises to adopt energy-efficient and carbon-neutral practices; *(b) e-commerce training:* provide funding for digital literacy initiatives to assist MSEs in utilizing online sales platforms effectively.

9. Implementation and monitoring stage is a crucial phase in the process, which can be executed through the following methods: *(a) pilot programs:* evaluate policies in free trade zones prior to a nationwide implementation; *(b) feedback mechanisms:* leverage big data to evaluate the effectiveness of policies and make real-time adjustments.

By integrating tax incentives, direct subsidies, improved financing options, and enhanced market access, China can foster a more robust environment for micro and small enterprises, thereby promoting employment, innovation, and economic stability.

In the coming five years, digitalization is poised to be the foremost catalyst for transformation among China’s micro and small enterprises, fundamentally altering their operational methods, competitive strategies, and growth trajectories. Artificial Intelligence and Automation represent a pathway to exceptional efficiency at minimal expense. Small businesses will increasingly implement AI chatbots, such as Alibaba’s Tongyi Qianwen, to enhance customer service, utilize AI for inventory management, and automate HR and payroll processes, achieving cost reductions of 20-30%. MSEs in the retail and manufacturing sectors will leverage AI to predict demand, optimize pricing strategies, and minimize waste. Additionally, platforms like Tencent’s Weimeng will empower MSEs to create applications and websites without the need for coding, thereby broadening access to digital capabilities [14; 164].

E-Commerce 3.0 will transcend traditional online sales, with live commerce emerging as a dominant force. By 2028, platforms such as Douyin (TikTok), Kuaishou, and Xiaohongshu are projected to contribute over 40% of sales for micro and small enterprises (MSEs), utilizing AI-generated livestreams and virtual hosts. WeChat Mini-Programs and Alibaba’s Taobao Deals will facilitate the integration of shopping into social interactions, including group purchases and collaborations with influencers. Additionally, platforms like Temu and SHEIN will empower even the smallest MSEs to reach global markets with minimal initial investment. Digital finance and payment solutions are enhancing cash flow for MSEs. These enterprises will leverage smart contracts to facilitate instant tax rebates, streamline supply chain payments, and access microloans. MYbank (Ant Group) and WeBank will provide AI-based credit scoring, enabling MSEs without collateral to secure loans at interest rates below 5%. Furthermore, small exporters will adopt blockchain technology to authenticate transactions, thereby minimizing fraud in international trade.

Smart Supply Chains Empower Competition Against Industry Giants. Platforms like Alibaba’s “Lingxi” and JD’s supply chain solutions will enable MSEs to monitor inventory in real time, share warehouse facilities, and consolidate logistics efforts. Small manufacturers in regions such as Zhejiang or Guangdong will connect digitally to collectively bid for substantial contracts, such as those from Apple or Tesla. Local MSEs will leverage distributed 3D printing hubs to create customized components without incurring significant capital expenditures. Digital Inclusion Aims to Bridge the Rural-Urban Divide. Rural MSEs will utilize AI-driven design tools, such as Alibaba's "Rhino" for product prototyping, to enhance traditional crafts for international markets. Small agricultural operations will implement smart sensors and drone technology for spraying, selling their products directly through Pinduoduo's agricultural platforms. County-level "Common Prosperity" centers will provide complimentary SaaS tools and training resources to support rural entrepreneurs. So, In the next five years, China’s micro and small enterprises will experience significant transformation driven by digitalization, policy support, and shifting market dynamics (see fig. 3.7). Here are the key trends and new growth avenues for MSEs in China:

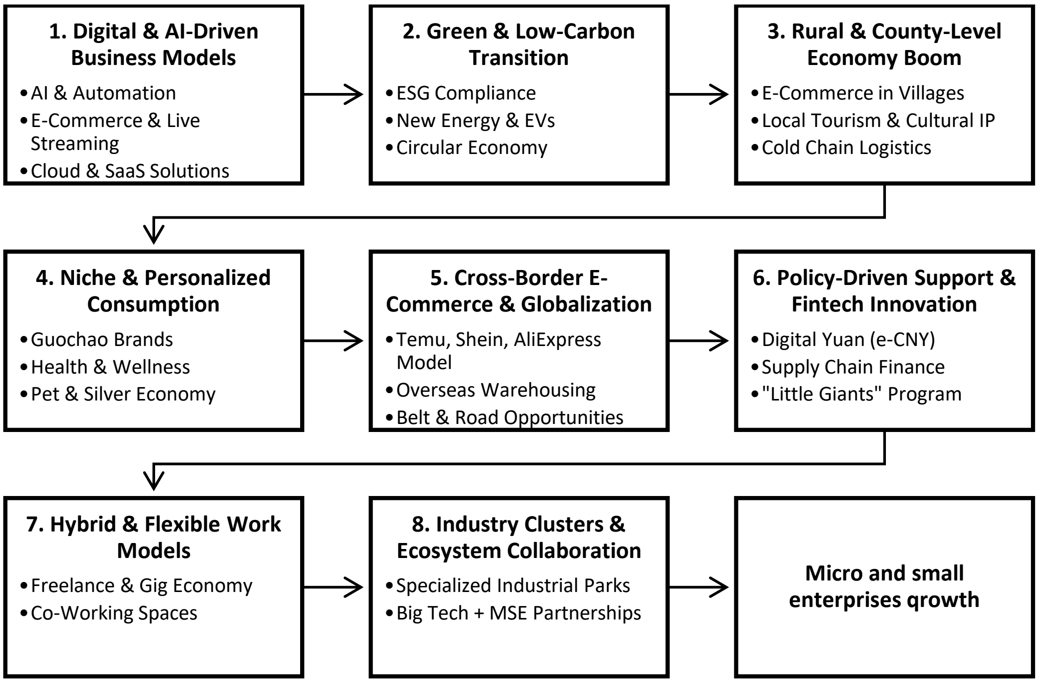


**Fig. 3.7. New ways and tendencies for development MSEs in China**

Source: [Author]

1. Digital and AI-driven business models: *(a) AI and automation:* micro and small enterprises are expected to integrate AI technologies, such as virtual assistants similar to ChatGPT, AI-driven customer support, and automated inventory management systems, to reduce expenses and enhance operational efficiency; *(b) e-commerce and live streaming:* platforms like Douyin (TikTok), Kuaishou, and Pinduoduo will continue to serve as vital sales avenues, with an increasing number of MSEs utilizing AI-generated content (AIGC) for their marketing strategies; *(b) cloud and SaaS solutions:* affordable software as a service (SaaS) platforms, including Alibaba Cloud and Tencent Weimeng, will assist MSEs in digitally managing their human resources, financial operations, and logistics.

2. Green and low-carbon transition: *(a) ESG compliance:* manufacturing micro and small enterprises will adopt environmentally friendly production methods, such as solar energy, recycling, and energy-efficient technologies, to align with China's carbon neutrality objectives; *(b) new energy and electric vehicles:* small suppliers involved in electric vehicle battery recycling, charging infrastructure, and related components are

expected to expand, bolstered by government support; *(c) circular economy:* there will be an increase in upcycling initiatives, second-hand marketplaces (like Xianyu), and sustainable packaging practices among small enterprises.

3. Rural and county-level economy boom: *(a) e-commerce in villages:* the emergence of Taobao Villages and Pinduoduo's agricultural supply chain will enhance the capabilities of rural micro and small enterprises; *(b) local tourism and cultural intellectual property:* initiatives such as homestays, handicrafts, and rural tourism will thrive under "rural revitalization" policies; *(c) cold chain logistics:* enhanced cold storage and distribution systems will facilitate the growth of small agricultural businesses.

4. Niche and personalized consumption: *(a) guochao (国潮) brands:* emerging companies in traditional Chinese apparel, tea, and cosmetics are expected to benefit from rising patriotic consumer trends; *(b) health and wellness:* the increasing interest in Traditional Chinese Medicine, organic food, and fitness technology will present new opportunities; *(c) pet and silver economy:* the markets for pet care, health products for seniors, and smart home technologies catering to an aging demographic are anticipated to expand.

5. Cross-border e-commerce and globalization: *(a) Temu, Shein, and AliExpress model:* an increasing number of micro and small enterprises will engage in global sales through Direct-to-Consumer (DTC) cross-border platforms; *(b) overseas warehousing:* government-supported logistics centers, particularly in regions such as ASEAN and the Middle East, will help lower export expenses; *(c) Belt and Road Initiative (BRI) opportunities:* MSEs operating in sectors like construction, machinery, and digital services will seek to enter BRI markets.

6. Policy-driven support and fintech innovation: *(a) digital yuan (e-CNY):* micro and small enterprises will utilize Central Bank Digital Currency (CBDC) for tax refunds, subsidies, and expedited transaction processes; *(b) supply chain finance:* lending solutions based on blockchain technology, such as Ant Group's MYbank, will enhance credit accessibility for MSEs; *(c) "little giants" (小巨人) program:* an

increased number of MSEs operating in high-tech industries, including semiconductors, robotics, and biotechnology, will benefit from government funding.

7. Hybrid and flexible work models: *(a) freelance and gig economy:* platforms such as Zhubajie (猪八戒) will allow micro and small enterprises to engage remote professionals for services in design, programming, and consulting; *(b) co-working spaces:* Shared office environments in smaller cities will help startups lower their rental expenses.

8. Industry clusters and ecosystem collaboration: *(a) specialized industrial parks:* micro and small enterprises focused on semiconductors, electric vehicles, and artificial intelligence will be concentrated in government-backed areas, such as Shenzhen and Hefei; *(b) big tech and MSE partnerships:* companies like Alibaba, Tencent, and JD will provide cloud credits, data resources, and traffic assistance to support smaller vendors.

However, the development of micro and small enterprises in China faces several challenges and risks. A primary concern is regulatory compliance, as stricter data protection laws (such as the Personal Information Protection Law) and environmental, social, and governance (ESG) regulations may lead to increased operational costs. Additionally, labour shortages pose another significant issue; an aging population coupled with a lack of skilled workers could impede growth. Furthermore, geopolitical risks, particularly the tensions between the United States and China, may adversely impact cross-border e-commerce for MSEs. The MSEs in China that are likely to thrive will be those that utilize artificial intelligence, sustainable technology, cross-border e-commerce, and government policy incentives. The government's emphasis on "dual circulation", which encompasses both domestic and international markets, along with a commitment to technological self-sufficiency, will influence the available opportunities. So, as the result of research, we propose the fiscal policy model for the development of micro and small enterprises (see fig. 3.8) which include collaboration of: targeted stimulus and liquidity support; resilience-building subsidies; innovation and market adaptation incentives; inclusive support for rural and vulnerable MSEs.

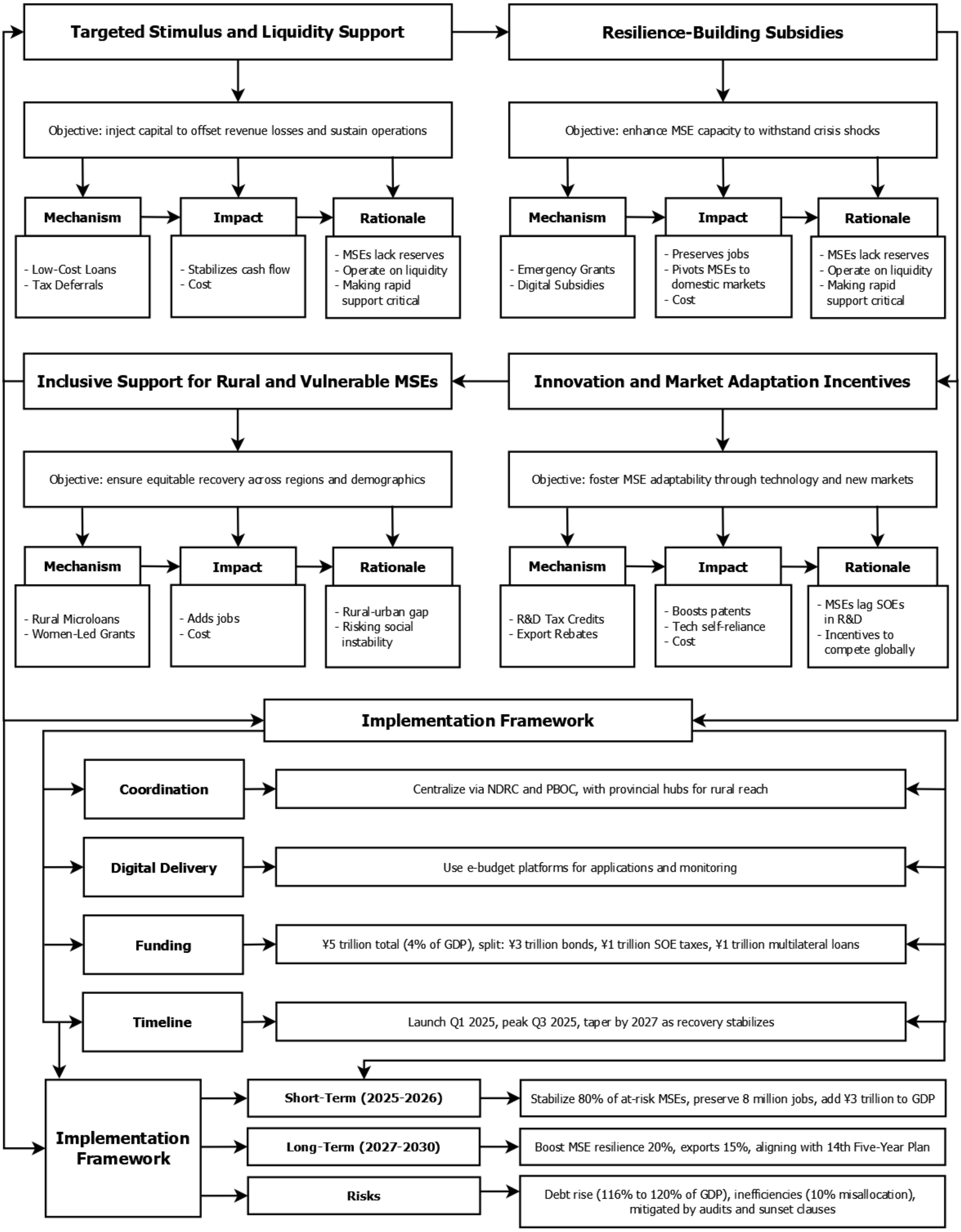


**Fig. 3.8. Fiscal policy model for the development of micro and small enterprises**

Source: [Author]

This fiscal policy framework, which integrates stimulus, resilience, innovation, and inclusion, provides a strong foundation for the development of micro and small enterprises in China during a worldwide crisis. By utilizing China's financial resources and digital advantages, it can alleviate revenue losses and support MSEs as vital components of the economy. Effective execution requires a careful balance of costs, targeting, and equity to enhance its effectiveness. By 2025, in the face of global challenges, this model equips China to safeguard and strengthen its MSEs, facilitating their recovery and growth. Crisis-driven fiscal priorities for micro and small enterprises aim to stabilize these businesses, enabling them to act as buffers against unemployment and economic fluctuations. Several significant challenges exist: a decline in global demand, which particularly affects export-oriented MSEs; increasing input costs, including energy and materials, leading to reduced profit margins; and constrained credit markets, resulting in cash flow difficulties.

The essential fiscal policy measures include: tax relief and deferrals, such as VAT exemptions, corporate tax reductions, and subsidies for social security and rent; direct financial support, comprising targeted grants, employment subsidies, and vouchers for digital transformation; enhanced credit access through state-backed loan guarantees, relending programs from the People's Bank of China, and partnerships with FinTech companies; and demand-side stimulus, which involves government procurement quotas, consumer vouchers, and export tax rebates. Rural micro and small enterprises ought to be granted additional subsidies to support agricultural e-commerce initiatives, such as Taobao Villages, as well as for cold-chain logistics. Industrial clusters should be provided with tax exemptions for MSEs operating within critical supply chains, including EVs and semiconductors. Furthermore, "Little Giant" MSEs should prioritize research and development grants aimed at niche technology companies to facilitate the substitution of imported components. Local governments encounter limitations in financing relief initiatives. Smaller municipalities often do not possess the necessary resources to implement subsidies effectively. There is a need for structural reforms in the economy, such as enhancing digital skills.

**Conclusions to chapter 3**

To promote the development of micro and small-sized enterprises in China, targeted policy adjustments are essential. Capacity-building initiatives play a vital role in narrowing the development gap by equipping MSEs with the necessary skills and knowledge. Inclusive policies, such as tax incentives for women entrepreneurs, can also address structural inequalities and promote broader economic participation. Adaptive taxation strategies are particularly effective, as they provide flexible tax policies tailored to the economic environment, firm size, and sector-specific challenges. This dynamic approach enables a more responsive and supportive fiscal framework for MSEs. The integration of the digital economy offers transformative potential for MSEs. Embracing technologies such as e-commerce, cloud computing, and artificial intelligence can enhance operational efficiency, market reach, and competitiveness. Supporting MSEs in digital adoption is crucial for future-proofing their business models. Green and sustainable financing is another key pillar for MSE development. Access to green loans, bonds, and sustainability-focused grants not only supports environmental goals but also positions MSEs to thrive in the evolving global market. Finally, the availability of accessible financial resources including affordable credit, grants, and equity financing is fundamental. These financial instruments underpin growth, promote innovation, and build resilience among MSEs, reinforcing their critical role in China's economic transformation.

The transformation of fiscal policy in response to global economic crises requires a strategic, sustainable, and adaptable approach. Effective fiscal crisis mitigation depends on five key principles: affordability, predictability, targeting, resistance to misuse, and reversibility. By adhering to these principles, governments can develop policies that are both fiscally responsible and responsive to urgent needs. Prioritization is essential especially in countries lacking strong social safety nets where fewer, more focused measures improve targeting efficiency and administrative feasibility. Broad tax reforms are often ineffective due to implementation challenges and their limited impact on consumer prices. Instead, governments should review existing subsidy systems, ensuring that financial assistance is well-targeted, particularly amid inflationary pressures in food, energy, and fertilizer markets. Energy policy must align with climate goals, avoiding market distortions that could undermine carbon reduction efforts. Effective tools include carbon taxes, windfall profit taxes, and targeted support for vulnerable populations rather than generalized price controls. For future fiscal development, targeted tax incentives, subsidies for innovation, and public procurement preferences can stimulate investment, research, and sustainable growth. Additionally, counter-cyclical fiscal measures help stabilize economies across business cycles. Finally, regional and global cooperation in fiscal policy enhances countries' capacity to respond to cross-border challenges, promoting coordinated and resilient economic recovery.

The proposed fiscal policy model for the development of micro and small enterprises in China emphasizes a comprehensive and strategic approach aimed at fostering growth, resilience, and innovation. Key components include tax incentives, direct subsidies, improved financing mechanisms, and a reduction in administrative burdens. These measures are designed to ease operational constraints and create a more supportive business environment for MSEs. Direct fiscal subsidies, particularly those targeting innovation, employment, and digital transformation, play a crucial role in enhancing competitiveness. Access to financing is supported through credit guarantees, interest subsidies, and venture capital, which are essential for mitigating financial risks and encouraging business expansion. Operational cost reductions such as rent relief, utility subsidies, and streamlined regulations further strengthen business viability. To boost market demand, government procurement policies, inclusion in supply chains, and export assistance are vital tools. Regional and sector-specific support ensures equitable development, especially in rural and underdeveloped areas. Enhanced financial supervision and anti-monopoly enforcement promote fair competition and timely payments to MSEs. Support for digitalization and green technologies aligns MSEs with future economic trends. Growth opportunities also arise from AI-driven business models, personalized consumption, and cross-border e-commerce. Ultimately, the fiscal policy model integrates targeted stimulus, resilience-building, innovation support, and inclusive development to drive sustainable MSE advancement.

The main scientific results were published in the following scientific articles: 162; 163; 164; 165; 166; 167; 168; 169; 170; 171.

## CONCLUSIONS

1. In conclusion, the analysis shows that fiscal policy's success depends on economic context, institutional strength, and fiscal space. While developed countries benefit from automatic stabilizers due to broader tax systems and stronger institutions, developing nations struggle with limited capacity and fiscal constraints. Fiscal interventions must be carefully timed, as excessive spending during inflation or external deficit periods can worsen macroeconomic conditions. A key takeaway is the need for balance: short-term fiscal stimulus should not undermine long-term objectives like savings, capital growth. Effective fiscal policy must be adaptive, context-aware, and strategically aligned to avoid weakening financial stability or private investment.

2. Micro and small enterprises are essential to job creation and inclusive growth, especially in developing countries. However, their potential is limited by structural barriers such as corruption, complex regulations, poor infrastructure, and restricted access to finance and justice. Effective support for MSEs requires targeted reforms streamlining registration, improving taxation, and expanding access to legal and financial systems. Recognizing their unique needs through a differentiated policy approach, rather than uniform treatment, can enhance their sustainability. Encouraging formalization and fostering public-private dialogue are crucial steps. Ultimately, empowering MSEs enables them to become catalysts for innovation, economic resilience, and poverty alleviation.

3. Fiscal and financial support mechanisms for micro and small enterprises are vital for promoting growth, innovation, and employment. Subsidies, tax incentives, and procurement policies offer important benefits, but their impact is often weakened by bureaucratic inefficiencies, poor coordination, and limited funding. While these tools improve resilience and encourage formalization, many focus on short-term survival rather than long-term competitiveness. Problems such as growth traps and unfair market dynamics also persist. To be more effective, fiscal policy must be strategically designed to combine immediate financial support with long-term structural solutions, including improved access to technology, skill development, and transparent implementation.

4. The analysis underscores the strategic importance of fiscal policy and government net lending in supporting economic growth and social development. In China, empowering local governments to use special bonds for land reserves and housing demonstrates targeted fiscal intervention. Increasing income, strengthening social protection, and encouraging new consumption patterns are vital for boosting domestic demand. Government net lending, especially when it results in productive investment during downturns, can drive Real GDP growth more effectively than monetary policy. However, overuse of deficit financing risks fiscal instability. Therefore, fiscal measures must be context-sensitive, balancing short-term stimulus with long-term sustainability and debt reduction during stable periods.

5. Financing for MSEs in China remains constrained by perceived lending risks and modest returns, a situation worsened by the COVID-19 pandemic. Although policy measures have provided some relief, small banks still face high non-performing loans and shrinking margins, limiting credit availability. Encouragingly, the loan rejection rate for MSEs was low at 3.6% in 2022, with a high utilization rate of 87.7%. However, interest rate disparities persist, with MSEs paying more than large firms. As private businesses now make up over 96% of entities in China, supporting their growth is vital for long-term economic resilience and innovation under the 14th Five-Year Plan.

6. Geopolitical tensions, such as conflicts in the Middle East and Ukraine, pose significant threats to global stability by raising sovereign risks and destabilizing energy markets. Rising trade protectionism further undermines international cooperation and trade flows. The transition to a high-interest-rate environment is increasing borrowing costs as older debts mature, potentially reducing consumption and business investment. Financial market volatility may rise if economic growth slows more than expected or if disinflation efforts falter. Meanwhile, divergent monetary policies rate cuts in advanced economies and mixed trends in emerging markets reflect differing economic pressures. Governments are also introducing structural reforms to ensure fiscal sustainability, signaling complex policy trade-offs in an uncertain global environment.

7. Targeted fiscal and policy measures are crucial to advancing MSEs in China. Capacity-building programs help bridge skill gaps and improve competitiveness, while

inclusive policies like tax incentives for women foster greater economic participation. Adaptive tax strategies tailored to firm size and sector create a more responsive fiscal environment. Embracing digital tools e-commerce, AI, and cloud computing enhances efficiency and market access, making digital integration vital for MSE sustainability. Green financing instruments such as loans and sustainability grants support environmental goals while driving innovation. Accessible credit and equity financing remain fundamental for fostering MSE resilience, growth, and their broader contribution to China's long-term economic transformation.

8. To effectively respond to global economic crises, fiscal policy must be strategic, sustainable, and adaptable. Key principles such as affordability, predictability, targeting, resistance to misuse, and reversibility guide governments in crafting fiscally responsible policies. Prioritizing targeted measures, particularly in countries with weak social safety nets, improves efficiency and feasibility. Broad tax reforms often lack impact, so governments should refine existing subsidy systems and focus on well-targeted financial assistance. Policies must align with climate goals, utilizing tools like carbon taxes to avoid market distortions. Stimulating innovation through targeted tax incentives and public procurement preferences fosters sustainable growth, while counter-cyclical measures stabilize economies.

9. The proposed fiscal policy model for micro and small enterprises in China focuses on fostering growth, resilience, and innovation through strategic measures. Key components include tax incentives, subsidies, improved financing, and reduced administrative burdens. These policies aim to alleviate operational constraints and create a supportive business environment. Specific measures, like direct fiscal subsidies for innovation and digital transformation, enhance competitiveness. Financing options such as credit guarantees and venture capital mitigate risks. Additionally, cost reductions, market demand stimulation, and support for digital and green technologies align MSEs with future economic trends. The model also ensures equitable development across regions and sectors, driving sustainable MSE growth.

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# ANNEXES

## Annex A

| | Number | Percent |
|---|---|---|
| Shanghai | 855 | 19.10% |
| Guangdong Province | 611 | 13.60% |
| Jiangsu Province | 585 | 13.10% |
| Beijing | 573 | 12.80% |
| Other | 567 | 12.70% |
| Zhejiang Province | 562 | 12.60% |
| Shenzhen | 473 | 10.60% |
| Tianjin | 252 | 5.60% |
| **Total** | **4,478** | **100%** |

**Table A1. Main locations of business in China**

| | | Number | Percent |
|---|---|---|---|
| Introverted: Business in China accounts for more than 50% of the total revenue (N=1,149; Share=78%) | 100% | 632 | 42.9% |
| | 75%-99% | 373 | 25.3% |
| | 50%-74% | 144 | 9.8% |
| Extroverted: Overseas Business accounts for more than 50% of the total revenue (N=323; Share=22%) | 25%-49% | 98 | 6.7% |
| | 1%-24% | 179 | 12.2% |
| | 0% | 24 | 1.6% |
| | Not sure | 22 | 1.5% |
| | **Total** | **1,472** | **100.0%** |

**Table A2. Revenue contribution of business in China**

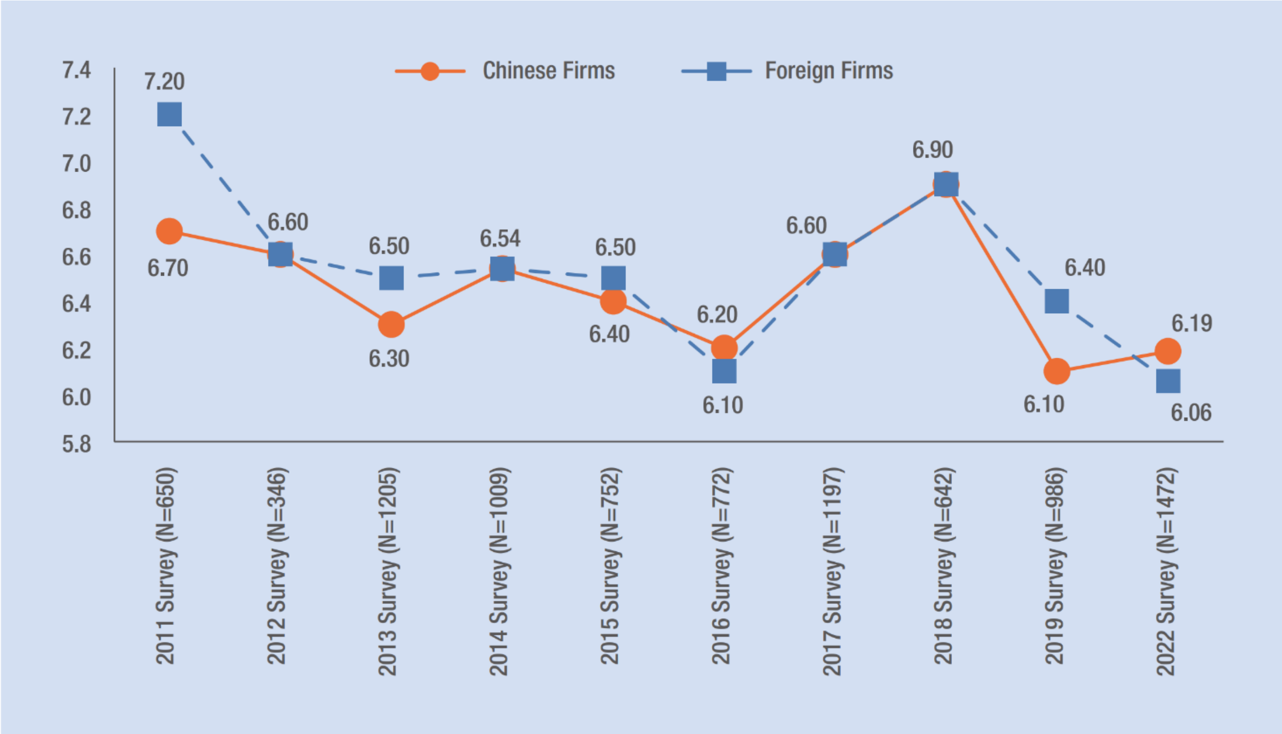


**Fig. A1. Short-term confidence of companies to operate successfully in China**

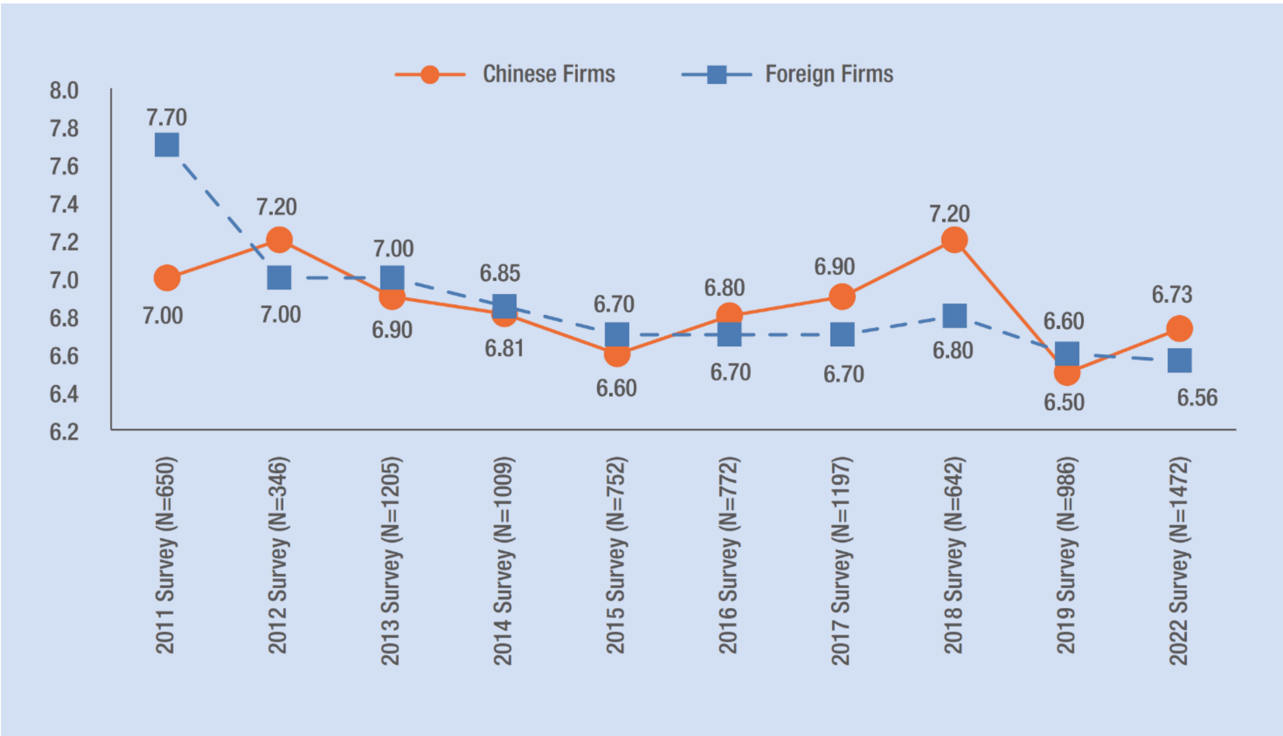


**Fig. A2. Medium-term confidence of companies to operate successfully in China**

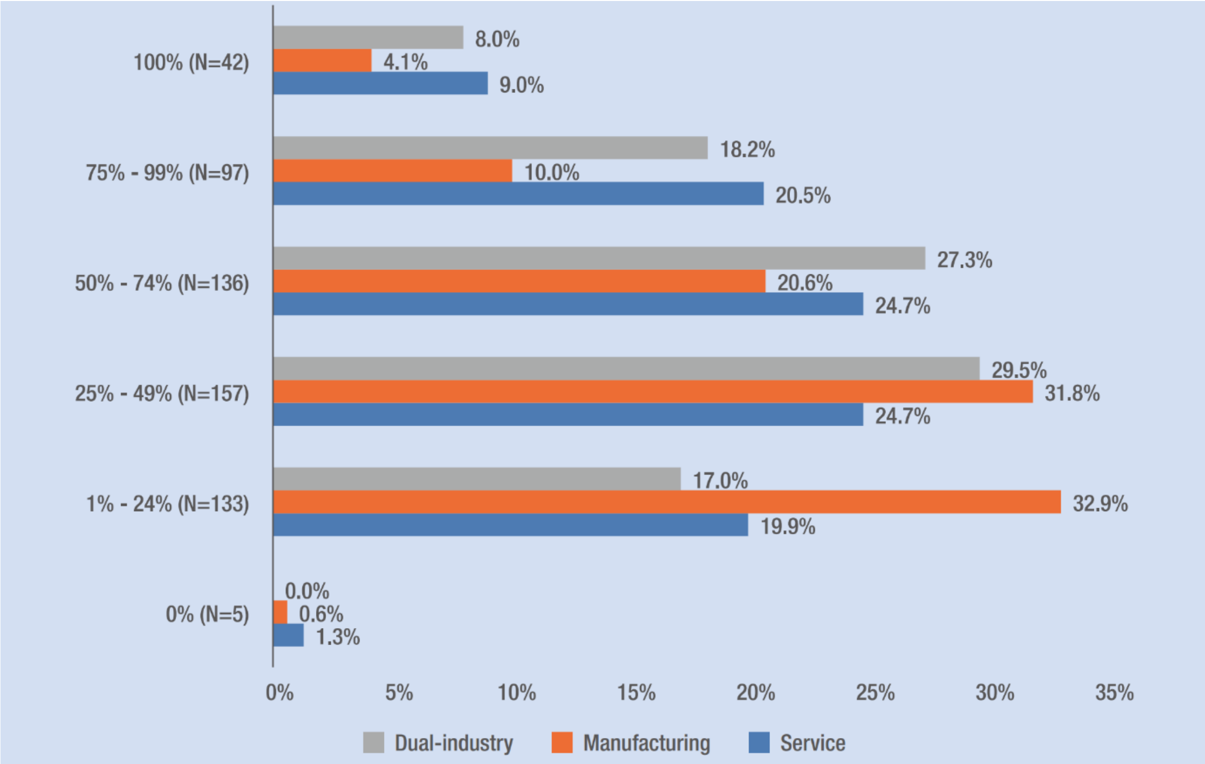


**Fig. A3. % of revenue decline attributed to COVID-19, by industry, China**

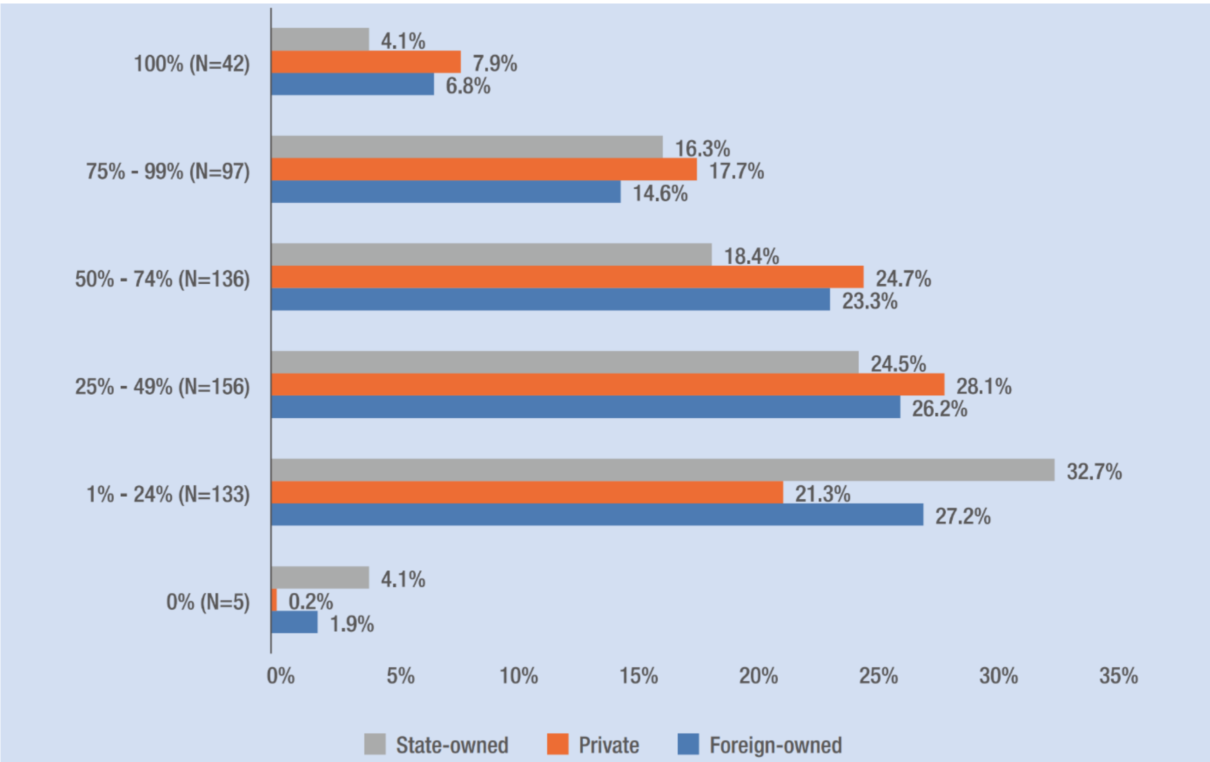


**Fig. A4. % of revenue decline attributed to COVID-19, by ownership, China**

**Continuation of Annex A**

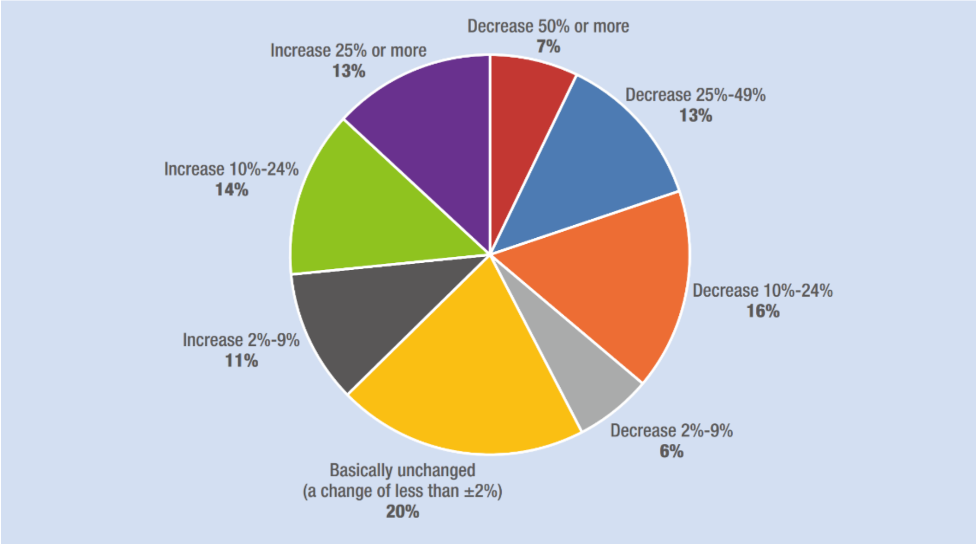


**Fig. A5. Changes in revenue, China, 2022**

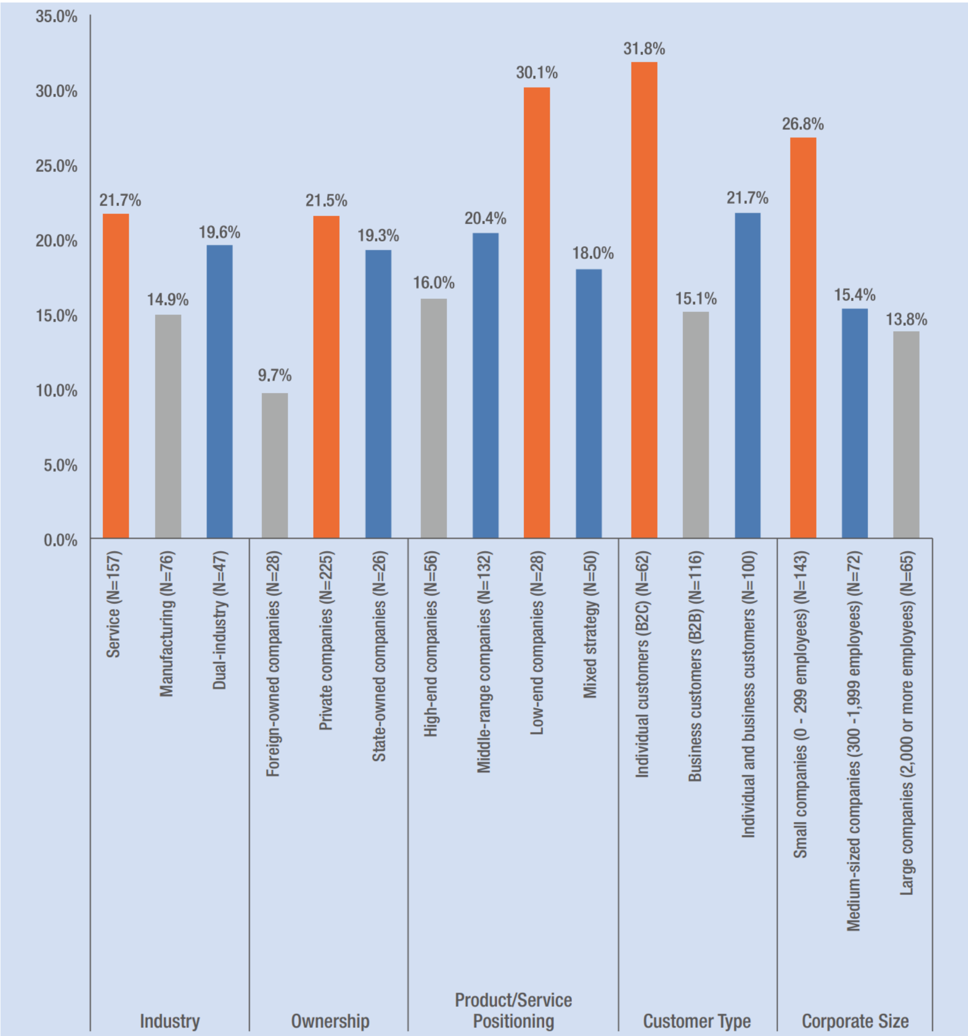


**Fig. A6. Proportion of companies with a significant revenue decline, China**

**Annex B**

МІНІСТЕРСТВО ОСВІТИ І НАУКИ УКРАЇНИ
ЗАХІДНОУКРАЇНСЬКИЙ НАЦІОНАЛЬНИЙ УНІВЕРСИТЕТ
НАУКОВО-ДОСЛІДНА ЧАСТИНА

46009, Україна, м. Тернопіль, вул. Львівська, буд. 5А, тел. (0352) 51-75-52

№ 21/ 54 - 2025 «25» 04 2025 року

## ДОВІДКА

Видана **ЧЖУ Ліхун**, про участь у виконанні науково-дослідних робіт, які виконуються Західноукраїнським національним університетом. Зокрема, результати дослідження використані при розробці фундаментальної держбюджетної НДР на тему: «Концепція відбудови та зеленої реконструкції України» (державний реєстраційний номер 0124U000003).

Начальник науково-дослідної частини Віта СЕМАНЮК

МІНІСТЕРСТВО ОСВІТИ І НАУКИ УКРАЇНИ ЗАХІДНОУКРАЇНСЬКИЙ НАЦІОНАЛЬНИЙ УНІВЕРСИТЕТ НАУКОВО-ДОСЛІДНА ЧАСТИНА 33680120

JIU No. 21 from April 24, 2025

To the specialized scientific council
Western Ukrainian National University

**CERTIFICATE**
**on using the results of qualification work of**
**Zhu LIHONG**

We confirm that the results of Zhu Lihong's qualification work on the topic: "The impact of fiscal policy on small and micro enterprises under global economic crisis" have been used and implemented by Jiu quan Xing rongtong Accounting Agency Co.Ltd.

Under the guidance of Doctor of Economic Sciences, Prof. Roman Zvarych, combined with my own major, my teaching work and the research direction of my doctoral thesis, I served local small and low-profit enterprises and studied the domestic teaching research results.

The relevance of the study is due to the fact that micro and small enterprises can effectively provide employment opportunities and promote income growth, and are considered to be a "stabilizer" for building a harmonious society, which is of great significance to economic and social development, especially for our developing country in transition.

The performance of scientific work is aimed at studying the government support policies for MSMEs in China against the background of financial crisis, using finance as the entry point.

The results obtained in the research process can be implemented in the process of forming and implementing the economic and social development program of Jiu quan Xing rongtong Accounting Agency Co.Ltd.

**Legal representative**

**Jiu quan Xing rongtong Accounting Agency Co.Ltd.**

**April 24, 2025**

**Continuation of Annex B**

JIU No. 19 from April 24, 2025

To the specialized scientific council
Western Ukrainian National University

**CERTIFICATE**
**on using the results of qualification work of**
**Zhu LIHONG**

We confirm that the results of Zhu Lihong's qualification work on the topic: "The impact of fiscal policy on small and micro enterprises under global economic crisis" have been used and implemented by Jiu quan Vocation Technical College School of Economics and Management.

Under the guidance of Doctor of Economic Sciences, Prof. Roman Zvarych, combined with my own major, my teaching work and the research direction of my doctoral thesis, I served local small and low-profit enterprises and studied the domestic teaching research results.

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The results obtained in the research process can be implemented in the process of forming and implementing the economic and social development program of School of Economics and Management.

**The head of**
**Jiu quan Vocation Technical College School of Economics and Management.**

**April 24, 2025**

经济管理学院