# Analysis of the Inducement and Preventive Measures of Systemic Financial Risk from the Perspective of Financial and Fiscal Linkage

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***Abstract:*** The financial system is an indispensable component of the modern economy. As an important risk of the financial system, systemic financial risk has a significant impact on economic stability and development. Financial and fiscal linkage refers to the interrelationship and influence between financial and fiscal policies. With the close relationship between finance and treasury, the causative factors and preventive measures of systemic financial risk have also received increasing attention. The purpose of this paper is to analyze the main causes of systemic financial risk from the perspective of financial and fiscal linkage, and then discuss the corresponding preventive measures, so as to provide theoretical support and policy recommendations for financial stability and sustainable economic development.

***Keywords:*** Financial and Fiscal Linkages; Systemic Financial Risk; Causal Factors; Preventive Measures

## 1. Introduction

As a core component of the modern economy, the financial system plays an important role in promoting economic growth and resource allocation. However, in recent decades, a number of financial crises have occurred globally, triggering widespread concern about systemic financial risks. Under the perspective of financial and fiscal linkage, it has become particularly important to explore the causative factors and preventive measures of systemic financial risk. Systemic financial risk refers to a series of interrelated and interacting risks in the financial system, which is characterized by global, contagious and infectious. This paper will carry out research from the following aspects: First, introduce the concept and relationship between financial and fiscal linkage. Second, analyze the causative factors of systemic financial risk under financial and fiscal linkage. Finally, it proposes preventive measures against systemic financial risks under the linkage of finance and fiscal, with a view to providing theoretical support and policy guidance for improving the healthy development of the financial system [Yinglan Z,Yi L,Chen F. 2022].

## 2. The Concept and Relationship between Financial and Fiscal Linkages

Financial and fiscal linkages refer to the interrelationship and interaction between the financial and fiscal systems. The two are closely related and interdependent in the modern economy. It is mainly manifested in the following aspects. Firstly, there is fund sourcing and utilization. Financial institutions acquire funds through activities such as deposit-taking and bond issuance, which are then directed towards various economic activities to facilitate resource allocation and investment. In contrast, the fiscal system raises funds through means like taxation and issuing government bonds, which are utilized for national economic development and expenditure on social public affairs. Therefore, the fund sourcing and utilization of financial institutions are directly influenced by fiscal policies and the fiscal situation. Secondly, there is policy regulation and supervision. Fiscal policy and financial policy are two essential components of macroeconomic policies. Fiscal policy impacts economic operation and resource allocation through measures like adjusting taxation, expenditure, and debt, while financial policy primarily utilizes monetary policy and financial regulation to regulate financial markets and institutions. The two work in coordination and synergy to achieve the objectives of macroeconomic policies [Berman M D,J. R B,F. R J. 2022].

# 3. The Causes of Systemic Financial Risks under Financial and Fiscal Linkages

## 3.1 Causes in the Financial Sector

Triggers in the financial sector refer to a series of factors and events within financial markets and financial institutions. Through interconnections and interactions, they negatively affect the overall stability of the financial system, thereby triggering systemic financial risks. The following are some common financial sector triggers that lead to the emergence of systemic financial risks. First, credit risk and debt default. Financial institutions hold a large amount of debt assets, when debtors default or their solvency is impaired, financial institutions may face the risk of debt default. If debt defaults spread, they may trigger a crisis of confidence and liquidity problems among financial institutions, which in turn affects the stability of the entire financial system. Second, liquidity risk and fund runs. Financial market liquidity pressure refers to a situation in which market participants generally pursue liquidity while ignoring risk. When there is a collective run on demand by market participants, it may lead to a loss of funds in financial institutions, which in turn triggers a liquidity crisis in financial institutions and even spreads to the entire financial system. Third, the sharp fluctuations in market prices. Large fluctuations in financial market prices may trigger systemic risks. When there is a large-scale decline among market participants in general, it may trigger panic, prompting more investors to sell their assets in droves, which in turn exacerbates the market decline. Such a vicious market cycle could lead to the destabilization of the entire financial system.

## 3.2 Causes in the Fiscal Sphere

Fiscal triggers refer to the factors in the financial and fiscal linkage that have an impact on systemic financial risks, such as fiscal policies and fiscal conditions. The fiscal domain refers to the activities and decisions of the government and related institutions in terms of fiscal revenue, expenditure, and management. Here are some common fiscal triggers that can lead to the emergence of systemic financial risks. Firstly, fiscal deficits and debt issues. A fiscal deficit occurs when government expenditures exceed revenues, requiring borrowing to supplement funds. When fiscal deficits accumulate and debt levels become too high, it can trigger a debt crisis and have adverse effects on the financial system. The persistence and expansion of fiscal deficits may increase the risk of debt defaults, putting pressure on the stability of the financial system. Secondly, imbalances and adjustments in fiscal policies. Imbalances in fiscal policies occur when there is an unreasonable allocation and regulation of government expenditures and taxes. A lack of reasonable fiscal policy adjustments can lead to economic imbalances, misallocation of resources, and the accumulation of financial risks. For example, excessive expansion of government spending may result in inflationary pressures, fund shortages, and instability in financial markets. Lastly, weak fiscal regulation. Inadequate and insufficient fiscal regulation can result in unregulated and risky behaviors within the financial system. The absence of appropriate fiscal regulatory measures and systems may lead to the accumulation of risks and trigger systemic financial risks. For instance, improper management of public fiscal funds can exacerbate fiscal risks, thereby negatively impacting the stability of the financial system [Junzhi Z,Lei C. 2022].

# 4. Preventive Measures for Systemic Financial Risks under Financial and Fiscal Linkages

## 4.1 Strengthening Regulatory and Monitoring Mechanisms

Strengthening regulatory and monitoring mechanisms is a crucial measure to prevent systemic financial risks arising from the linkage between finance and fiscal affairs. Through effective regulatory and monitoring mechanisms, it helps identify and alert risks, enabling timely actions to maintain the stability of the financial system and the real economy. The specific measures include: Firstly, establishing a robust financial regulatory framework. Enhancing the powers and capabilities of financial regulatory institutions, refining financial regulatory laws and regulations, and establishing a scientific and effective financial regulatory framework. Strengthening the registration, access, and supervision of financial institutions, regulating behaviors in financial markets, and preventing financial misconduct. Secondly, strengthening risk assessment and emergency preparedness. Establishing and improving risk assessment systems, enhancing risk assessment of financial institutions and products. Setting up risk monitoring and early warning mechanisms to promptly identify and evaluate potential financial risks, and implementing corresponding risk control measures. Developing emergency response plans to ensure swift and orderly actions when financial crises occur. Thirdly, enhancing cooperation and communication. Establishing efficient mechanisms for financial regulatory cooperation, strengthening information sharing, cooperation, and coordination among domestic and international regulatory institutions. Strengthening collaboration with international financial institutions, drawing from international experiences and best practices, and collectively addressing cross-border financial risks [Zhou W.2021].

## 4.2 Improve Crisis Response and Risk Management System

By improving crisis response and risk management systems, the stability and resilience of the financial system can be enhanced, thereby reducing the occurrence and propagation of systemic financial risks. These measures need to be strengthened on the basis of international cooperation, with joint efforts to construct a stable and healthy financial system, promoting sustainable economic development. Firstly, establishing a crisis management mechanism is crucial. Setting up a robust financial stability committee or a similar institution responsible for formulating and coordinating crisis management policies and measures. This institution should have cross-sectoral and comprehensive capabilities to manage financial risks, possessing the authority and operational capacity to address systemic financial risks. Secondly, improving the risk assessment and monitoring system is essential. Strengthening the risk assessment and monitoring capabilities of financial institutions and markets to timely identify, evaluate, and warn about potential systemic risks. Introducing quantitative and qualitative analytical tools, establishing a risk indicator system, and enhancing risk control capabilities for different financial products, markets, and institutions. Thirdly, strengthening risk management and response capabilities is vital. Financial institutions should enhance their own risk management abilities, including risk pricing, risk diversification, and stress testing. Establishing effective risk management frameworks and equipping professional risk management teams to enhance the prevention and management capabilities of market liquidity risk, credit risk, operational risk, and others. Lastly, reinforcing the role and responsibilities of financial stability institutions is crucial. Enhancing the regulatory and supervisory role of financial stability institutions (such as central banks) and formulating and implementing necessary macroprudential policies. These institutions should possess effective measures and tools to swiftly intervene and stabilize financial markets and the operations of financial institutions in the event of a financial crisis [Zhu X.2020].

# Conclusion

Considering the causal factors and preventive measures of systemic financial risks from the perspective of the linkage between finance and fiscal affairs, we recognize the significance of the close connection between finance and fiscal policies for financial stability and sustainable economic development. Insufficient policy coordination, escalating leverage risks, and regulatory challenges are the key factors leading to systemic risks. Therefore, the government should enhance policy coordination to ensure consistency between financial and fiscal policy objectives. Simultaneously, strengthening the construction of financial regulatory and risk management mechanisms promotes the healthy development of the financial system. Through these measures, we can enhance the resilience of the financial system, reduce the impact of systemic risks on the economy, and lay a solid foundation for sustainable development.

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