

Course name: **Principles of finance**

The "**Principles of finance**" course aims to acquaint students with the structure and functioning of the financial system. The course is taught in two parts. In the first part students will examine the origin and evolution of money and banks. This part of the course will cover issues related to the organization, structure and functioning of the banking system and its elements – the Central Bank, commercial banks and non-bank financial institutions. Also, the course will consider questions regarding the goals and instruments of monetary policy, as well as the peculiarities and constraints in the conduct of monetary policy under a Currency Board arrangement. Students will learn the main items of the balance sheet of commercial banks and the operations they carry out in connection with mediation services provided, including non-cash payments. The second part of the course deals with public finances. Students will examine and discuss the theoretical foundations and principles of taxation. Special attention will be given to the tax system in Bulgaria by looking at various types of taxes and the mechanisms for their collection. The budget process (drafting, voting, implementation, and reporting) and the principles of fiscal policy will be studied as well.

The course will cover the following topics:

1. Money and monetary aggregates

Origin, nature, functions and role of money. The equation of exchange. Monetary aggregates. Supply and demand of money. Inflation and purchasing power of money.

2. Money markets and capital markets

Cash flow and financial intermediaries. Tools of money markets. Capital markets and capital markets instruments. Primary and secondary markets. International foreign exchange markets. Markets for derivatives (forwards, futures, options and SWAPs).

3. Banks and the banking system

Origin and evolution of banks. One-tier and two-tier banking system. Structure and functions of the Central Bank. Monetary and credit policy of the central bank. Supervision and regulation of the banking system. Legal forms, legal constraints, and licensing of banks. The Central Bank under a currency board arrangement. Economics of banks – liquidity, profitability, capital adequacy.

4. Interest rate

Nature and role of the interest rate. Measurement of interest rates: a simple and compound interest; present and future value; yield to maturity; current yield; discount yield basis; decursive and pre-calculated interest. Interest rate and return. Nominal and real interest rate. Risk and term structure of interest rates. Behavior of interest rates.

5. Liabilities and passive bank operations

Structure of liabilities. Equity and special requirements for capital adequacy. Capital standards and methods of measurement. Types of deposits – demand deposits, time deposits, saving deposits, special deposits. Interbank loans. Off-balance-sheet operations.

6. Assets and active bank operations

Bank reserves (cash and due from banks), securities, and loans, tangible and non-tangible assets. Reserve requirements. The process of extending loans. Credit risk and assessment of risk exposures of banks and the formation of provisions. Inter-bank active operations.

7. Public expenses

Theory of public expenses (public goods and services, public choice, cost-benefit analysis, Pareto efficiency, subsidies and taxes of Pigou). Types of public expenses (administrative expenses, military expenses, social and cultural expenses – education, health care, science, culture, sports, etc. public debt management, building and reconstruction expenses, etc)

8. Theory of Taxation

Origin and characteristics of taxation. Principles of taxation. Tax “anatomy” (elements of taxation). Types of taxation (proportionate, progressive, regressive). Scope of taxation. Efficiency and taxation. Optimal taxation and deadweight loss. Tax policy, public administration, tax procedures.

9. Indirect (turnover) taxes

Characteristics of indirect taxes. Value added tax. Excise duties. Custom duties

10. Direct (income) taxes

Characteristics of direct taxes. Corporate income taxation. Personal income taxation.

11. Property taxation and other public revenues

Characteristics of property taxes. Real estate tax. Inheritance tax. Donation tax. Tax on property purchase. Tax on vehicles. Patents, penalties, interest revenues and confiscations. State and local taxes (characteristics, types and organization).

12. Budget and budget policy

Budget origin and budget evolution. Characteristics, functions and role of state budget. Budget principles and methods of budgeting. Budget types. Budget process (preparation, adoption, completion, execution and reporting of individual budgets). Budget regulation and financial decentralization.

Method of assessment

- The final evaluation will be made using the following formula:

$$FG = 0.60 SE + 0.40 Q$$

Where

FG	=	final grade
SE	=	exam
Q	=	2 pop quizzes (tests)

- The final grade is from 2 to 6. Passing the course requires a minimum grade of 3. Transfers of credits is according to the following system:

Excellent /6/	Very good /5/	Good /4/	Average /3/		Weak /2/	
A	B	C	D	E	FX	F
Credits awarded.					No credits.	

Expected Course Outcomes

Those who successfully complete the course on Finance should be able to combine the theoretical knowledge with the particular skills acquired during the course.

The course will provide knowledge of and skills for:

- Students will gain knowledge about the origin and evolution of money and monetary systems. They will know about the theories and models useful in understanding the relationship between money and economic activity.
- Students will be acquainted with the principles of functioning and the structure of the financial system with a focus on the banking system. Basic bank products and the technology of banking will be considered as well.
- Students will be able to recognize the different types of monetary and fiscal policies and be ready to contemplate and discuss complex economic issues related to the financial system.

Recommended readings:

- Frederic Mishkin – The Economics of Money, Banking and Financial Markets Ninth edition, 2010, Addison-Wesley
- R. Glenn Hubbard, Anthony Patrick O'Brien – Money, Banking, and the Financial System, 2012, Pearson
- David N. Hyman – Public Finance: A Contemporary Application of Theory to Policy, Tenth edition, 2010, South-Western
- Jonathan Gruber – Public Finance and Public Policy, Third edition, 2011, Worth Publishers