



MACROECONOMIC POLICY

Goals

Tools

Types of Economic Policy

Efficiency of Economic Policy

Economic Policy

■ Definition:

- „the set of government rules and Regulations to control or stimulate the aggregate indicators of an economy“
- (<http://economictimes.indiatimes.com/definition/macroeconomic-policy>)

■ Areas covered

- taxation, government budget, interest rates, labour market, national ownership and others

■ Policy is directed to achieve particular **goals**

- target inflation
- unemployment
- economic growth
- ...

■ Tools ->

Example of Czech goals:

Inflation target: 2% (CNB, 2015)

Employment target: 75% for people between 20 – 64 years (government, objective to 2020)

Expenditures on research: 1% of GDP (government, objective to 2020)



MACROECONOMIC POLICY



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graph TD; A[MACROECONOMIC POLICY] --> B[MONETARY POLICY]; A --> C[FISCAL POLICY];
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MONETARY POLICY

Changes in money
supply

FISCAL POLICY

Government
spending and
taxation



Monetary Policy

- **Monetary policy**
 - is the government or central bank process of managing market economy. It involves operations with money, interests, loans etc.
- Governmental authorities can use direct and indirect instruments:
 - Direct instruments
 - **Regulation of investment loans** (to obtain a loan of extent exceeding level given by government an applicant has to submit to the bank approval from state authority)
 - **Regulation of consumption loans** (e.g. state-defined maximum maturity for loans)
 - **Other direct instruments** (e.g. loan ceilings)



Monetary Policy

- Indirect instruments

- **Policy of minimum required reserves** (central bank sets liability for commercial banks to store a portion of their assets on a non-interest account in a central bank)
- **Free market operations** (are the means of implementing monetary policy by which a central bank controls its national money supply by buying and selling government securities, or other instruments)
- **Discount rate policy** (discount rate is an interest rate on excess liquidity stored by commercial banks with the CNB)
 - ECB Deposit Facility interest rate (= discount rate) ... - 0.4% (Effective from 16 March 2016)



Types of Monetary Policy

- **Monetary policy** performed by central bank can be
 - Expansive policy
 - when money supply is raised by reduction of discount rate, purchase of securities etc.
 - Cutback policy
 - when money supply is reduced (augmentation of discount rate)



Fiscal Policy

- Fiscal policy

- actions of a government
- setting the level of public expenditure
- how that expenditure is funded

- influences government budget
 - Income side
 - Expenditure side



Fiscal Policy

- Income side (Revenues):

- is formed mainly by taxes. Tax is a financial charge or other levy imposed on an individual or a legal entity by a state. Tax system usually consists of:
 - **Direct taxes** are ones paid directly to the government by the persons (legal or natural) on whom it is imposed: in CZ income tax, road tax, real estate tax, real estate transfer tax
 - **Indirect taxes** are ones which are collected by intermediaries who turn over the proceeds to the government and file the related tax return: in CZ value added tax (VAT), consumer tax (alcohol etc.), ecological tax
 - **Other** revenues are various customs and administrative fees

- Expenditure side (Expenses):

- **Purchases of goods and services** (for national defense, government administration, education system etc.)
- **Transfer payments** (are payments of money from a government to an individual for which no good or service is required in return; e.g. unemployment benefit)



Types of Fiscal Policy

- **Expansionary fiscal policy** - an increase in government purchases of goods and services, a decrease in net taxes, or some combination of the two for the purpose of increasing aggregate demand and expanding real output.
- **Contractionary fiscal policy** - a decrease in government purchases of goods and services, an increase in net taxes, or some combination of the two for the purpose of decreasing aggregate demand and thus controlling inflation.
- **Neutral fiscal policy** - Modest fiscal policy. Generally not a common stance to take as there is no intention of affecting economic activity - this is rare, especially in contemporary times.
 - If revenues $>$ expenses \rightarrow surplus of national budget
 - If revenues $<$ expenses \rightarrow deficit of national budget



External Commerce and Monetary Policy

- **External commerce and monetary policy**
 - regulates flows of goods, services and capital that cross the country borders
 - each movement of goods, services and capital is reflected in country's balance of payments.
- A long-term equilibrium of **balance of payments** is one of conditions that qualifies fulfilment of final goals of stabilization policy.
- The change of exchange rate can influence the balance of payments.

Employment and Income Policy

■ Income policy

- wage and price controls used to fight inflation. State authority usually effect size of wage tariffs and prices so that profits are influenced indirectly.

■ Employment policy

- Functioning labour market

- Rate of Unemployment

- $$U = \frac{\text{job seekers registered at labour office between 15 – 64 years}}{\text{population between 15 – 64 years}}$$



Types of Economic Policy

■ Keynes's theory

- Keynesians require fast response of government to economy development and active correcting of economy failures
- **fiscal policy**

■ Neoclassical theory

- is based on the stimulation of aggregate supply
- main condition of market mechanism operation is price stability
- **monetary policy**

■ Neokeynes's theory

- Neokeynes's theory is developed from Keynes's theory. Neokeynesians want to realize their economic policy as a suitable **combination** of monetary and fiscal policy.



Efficiency of Economic Policy

- Generally, there are four basic goals of economic policy:
 - 1. Sufficient rate of unemployment
 - 2. Stability of price level
 - 3. Sufficient rate of real output growth
 - 4. Long-term equilibrium of balance of payments
- These goals are conflicting. Fulfillment of one goal (unemployment reduction) is in conflict with other goal (price level stability).
- Efficiency of economic policy can be measured e.g. by:
 - Magic tetragon
 - Philips curve

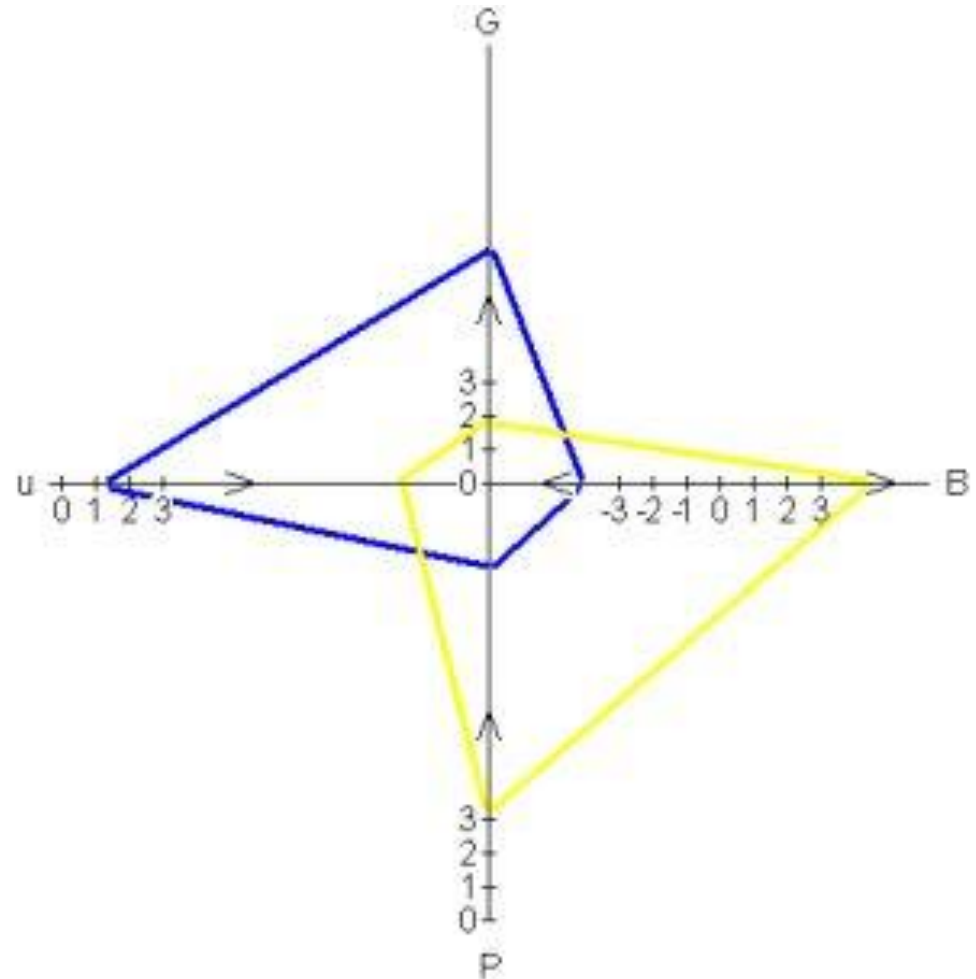


Magic Tetragon

- This controversy of mentioned four goals is described with “**magic tetragon**”. To represent graphically the efficiency of economic policy so called diamonds are used.
- The **shape** of diamond expresses efficiency of governmental policy on individual fields; as more far away is vertex from an intersection point of x and y , than the government was more successful in carrying the relevant goal.
- The **size** of diamond's area indicates total efficiency of stabilization policy. The greater the area is, the more successful the policy was.

Magic Tetragon

- G - average yearly rate of real **production growth**
- U - average yearly rate of **unemployment**
- I (P) - average yearly **inflation rate**
- B - average portion of **balance of payments** on current account as a part of national output in %

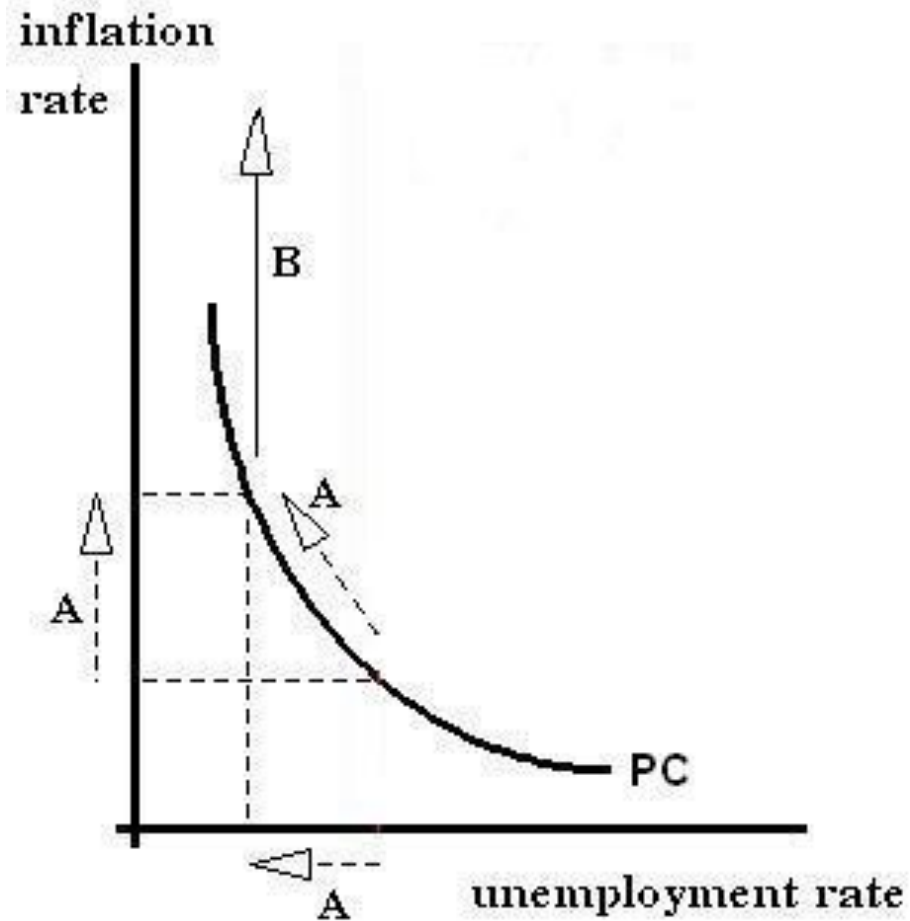




Philips Curve

- This analysis is related to the name of economist A.W.Philips, author of Philips curve.
- The **Phillips curve** is a historical inverse relation and tradeoff between the rate of unemployment and the rate of inflation in an economy. Stated simply, the lower the unemployment in an economy, the higher the rate of change in wages paid to labor in that economy.
- Drop of unemployment results in price level augmentation; lowering inflation leads to higher unemployment. The government has to decide between keeping high employment and the cost of high inflation or having stable prices but high unemployment.
- Government can influence the rate of unemployment and rate of inflation. These can be done e.g. by convincing employers and unions to reduce growth rate of prices and wages.

Philips Curve



Records related to CZ

■ Inflation

- 12/2007 ... 5,4%
- 12/2014 ... 0,1%



■ Unemployment

- 12/2007 ... 6,0%
- 12/2014 ... 7,5%





Resume

- Economic policy – goals & tools
 - Monetary – money, interests, loans
 - Fiscal – budget
 - External Commerce and Monetary Policy – int. trade
 - Income and Employment policies – wages, labour market
- Efficiency
 - Magic tetragon
 - Philip's curve