5.8 Supply-side policies

Name: _____ Class: _____ Date: _____ **Total: 30 marks**

KEY WORDS supply-side policy • market-based policy • interventionist policy • deregulation • privatization • human capital

Objective

Build the skills to answer exam questions on **supply-side policies** : market-based and interventionist policies, their effects on LRAS, AD and objectives, and their strengths and limits.

You must be able to:

- distinguish market-based and interventionist supply-side policies, with examples
- explain how supply-side policies shift LRAS and may also affect AD
- evaluate supply-side policies for growth, unemployment, inflation, equity and the environment

1 Key knowledge and worked examples

Supply-side policies

Supply-side policies aim to raise the economy's **productive capacity** and efficiency: they shift **LRAS (and the PPC) outwards**, raising potential output.

type	examples	how they work
market-based: competition	privatization, deregulation, trade liberalization, anti-monopoly law	more competition lowers costs and raises efficiency
market-based: labour market	lower minimum wage growth, less union power, cutting unemployment benefits, flexible hiring	lower labour costs and more incentive to work
market-based: incentives	lower income and corporate tax rates	more incentive to work, save, invest and start firms
interventionist	education and training (human capital), research and development, infrastructure, industrial policy (support for key industries)	the government directly raises the quantity and quality of factors of production

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Effects: LRAS shifts right: **higher growth without inflation**, lower natural rate of unemployment, more competitive exports. Interventionist spending also raises **AD** in the short run.

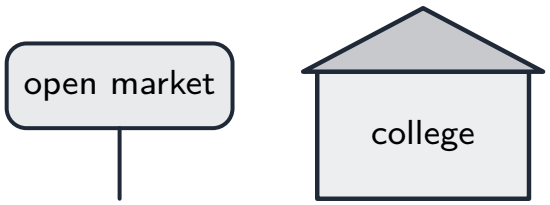
Evaluation:

strengths	weaknesses
long-run growth with low inflation	**long time lags** (education takes years)
lowers structural unemployment	interventionist policies are **costly** (opportunity cost, debt)
raises international competitiveness	market-based labour reforms can **increase inequality** and job insecurity
	deregulation can harm the **environment** or consumers
	tax cuts may mainly help high earners, and may not raise work effort

Answer shapes: LRAS shift diagram → name a specific policy → explain the mechanism → evaluate time, cost, equity and side effects.

2 Practice

2.1 Distinguish between a market-based and an interventionist supply-side policy, with an example of each. [2]



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2.2 State **two** ways in which spending on infrastructure can increase potential output. [2]

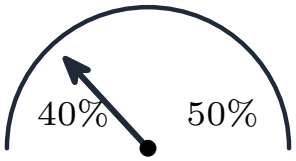


2.3 Using an AD/AS diagram, explain how investment in education and training can reduce unemployment without causing inflation. [4]



[[drawlines:4]]

2.4 A government cuts the top rate of income tax from 50% to 40%. Explain **two** reasons why this may not increase work effort much. [3]



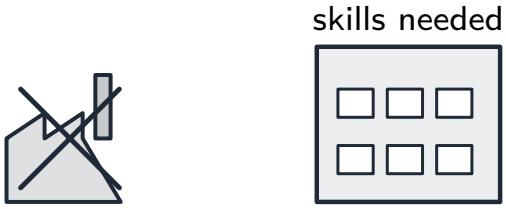
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2.5 Explain how privatization might raise efficiency in an industry, and **one** risk. [3]



3 Exam-style questions

3.1 A country has high structural unemployment and low productivity growth.

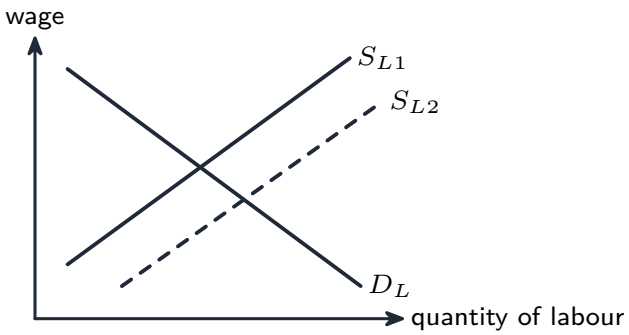


(a) Define **supply-side policies**. [2]

(b) Evaluate the use of interventionist supply-side policies to solve these problems. [6]

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3.2 A government plans to reduce unemployment benefits and the power of trade unions to make the labour market more flexible.



Evaluate these market-based supply-side policies. [8]

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Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

market-based: increases competition or incentives in markets, with little direct government spending, e.g. deregulation, lower corporate tax; interventionist: the government directly invests to improve supply, e.g. spending on education, infrastructure, R&D

2.2

any two: faster, cheaper transport lowers firms' costs; better links make markets larger and attract investment; reliable power and internet raise productivity

2.3

training gives workers the skills firms need, reducing structural unemployment; the quantity and quality of labour rises, so LRAS shifts right; real GDP rises while the price level stays the same or falls; correctly labelled diagram with $\text{LRAS}_1 \rightarrow \text{LRAS}_2$

2.4

higher after-tax pay means workers can earn the same income with fewer hours (income effect), which may offset the incentive to work more (substitution effect); many workers cannot easily change their hours; high earners may already work long hours, and pay may not be the main motive

2.5

private owners seek profit, so they have an incentive to cut costs and waste; they may face more competition and invest in new technology; risk: a private monopoly may raise prices or cut unprofitable services

3.1

(a) government policies that aim to increase the productive capacity (potential output) of the economy; by improving the quantity, quality or efficiency of factors of production / shifting LRAS right

(b) training and education match skills to jobs, reducing structural unemployment; R&D support and infrastructure raise productivity; spending also raises AD in the short run; but there are long time lags before the benefits appear; high cost: opportunity cost or more government debt; the government may pick the wrong industries or skills; judgement: suited to structural problems, but needs time and careful design

3.2

award up to [8]: lower benefits increase the incentive to search for and accept work; weaker unions mean wages adjust more easily, so firms may hire more; lower labour costs raise competitiveness and attract investment: LRAS shifts right; low cost to the government compared with interventionist policies; but they increase inequality and in-work poverty; less job security may lower worker morale and consumer spending; if unemployment

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is mainly cyclical or structural (skills), these policies do little; judgement: may raise flexibility but at an equity cost; best combined with training

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