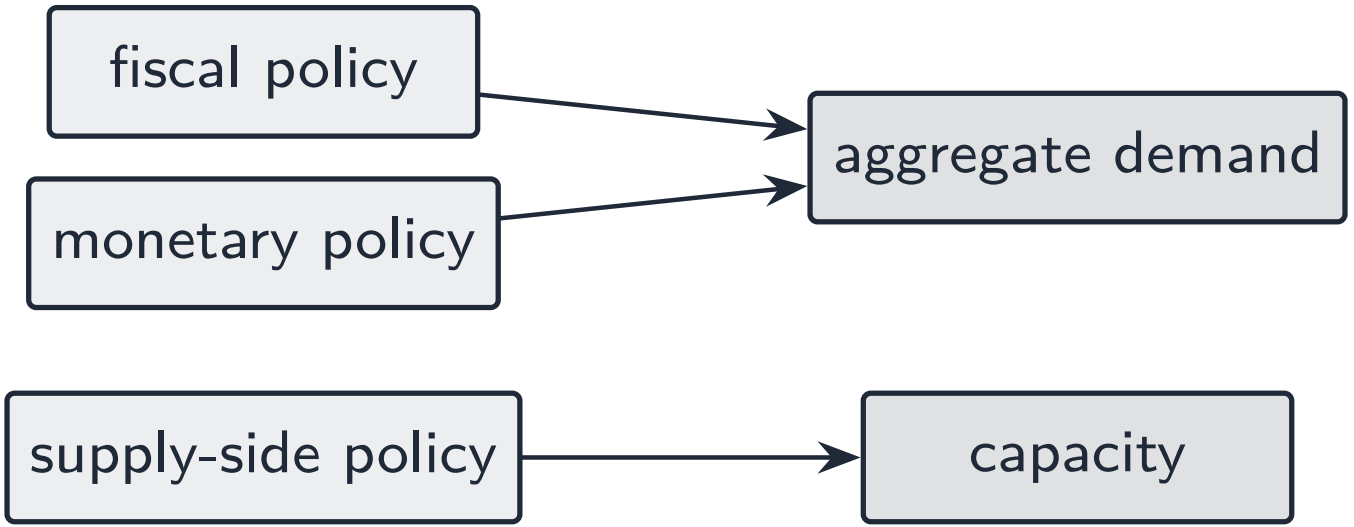
Exercise walk-through

4.8
Supply-side policies

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Figure: Macroeconomic activity, objectives and policy

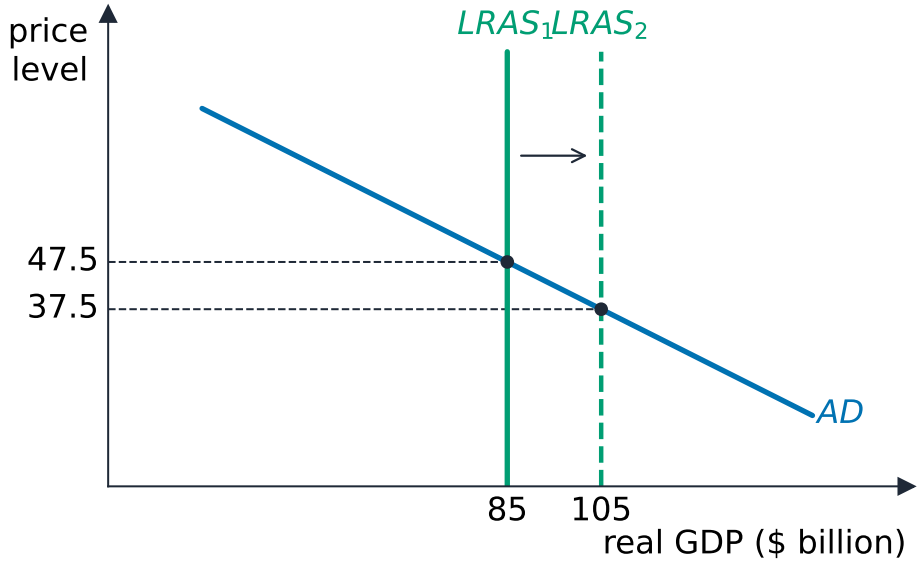


- Fiscal and **monetary policy** act on demand; supply-side on capacity
- Match each part of the diagram to the text.

Supply-side policies

- **Supply-side policies** aim to raise the economy's productive capacity, shifting LRAS to the right.
- **Worked example.** LRAS shifts from 85 to 105 along AD $P = 90 - Y/2$.
- The price level falls from $90 - 85/2 = 47.5$ to $90 - 105/2 = 37.5$ while real GDP rises by 20.
- Unlike demand-side policy, this gives growth without **inflation**.

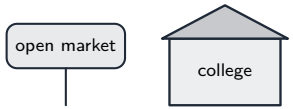
Figure: Supply-side policies



- Supply-side policy raises output and lowers the price level
- Match each part of the diagram to the text.

Exercises 2.1·2.2

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

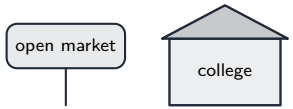


2.2 State **two** ways in which spending on infrastructure can increase potential output. [2]



Exercises 2.1·2.2

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



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



2.2

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

Exercise 2.3

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



[[drawlines:4]]

Exercise 2.3

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



[[drawlines:4]]

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 $\text{LRAS}_1 \rightarrow \text{LRAS}_2$

Exercise 3.1 (a)

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

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

Exercise 3.1 (a)

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

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

(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

Exercise 3.1 (b)

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

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



Exercise 3.1 (b)

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

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



(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