# 4.8 Supply-side policies

Name: _____ Class: _____ Date: _____ **Total: 16 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.

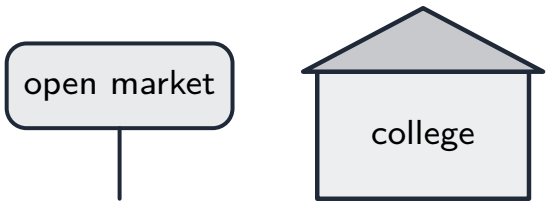
**Evaluation:**

| **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]]

## 3 Exam-style questions

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




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



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



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

**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



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