Exercise walk-through

4.4
Supply-side policy

IGCSE Economics

Policy tools – overview

Original policy choices: identify the tool and the mechanism

A government cuts income tax during weak spending. The central bank lowers its policy interest rate. A training programme helps unemployed mechanics qualify for new jobs.

Tool	Possible mechanism	Important limit
Fiscal	Lower tax leaves households more income to spend.	Households may save the extra income.
Monetary	Cheaper borrowing may encourage spending and investment.	Firms with few orders may still avoid borrowing.
Supply-side	Relevant skills may increase employability and capacity.	Training takes time; suitable vacancies must exist.

Supply-side tools, by name

Privatisation	**Privatisation** : selling a state industry to private owners, which may change incentives; private ownership alone does not create competition.
Deregulation	**Deregulation** : removing rules that keep new firms out, so incumbents face competition.
Incentives	Lower marginal tax rates and targeted subsidies change the **incentives** to work, save and invest.
Training	Relevant training can raise **productivity** and capacity when skills meet firms' needs; results take time.

> Supply-side policy shifts what the economy *can* produce. Demand-supporting policy can use spare capacity; spending on training or equipment can also affect future capacity.

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Exam tips

- Learn the government's five aims (growth, low unemployment, low inflation, balance of payments, fair incomes) – they can **conflict**, e.g. fast growth can pull up inflation.
- **Fiscal policy** = government spending and taxes; **monetary policy** = interest rates, money supply and exchange-rate measures; **supply-side policy** = raising what the economy *can* produce.
- Key rates: unemployment rate = unemployed ÷ labour force × 100; inflation rate = change in CPI ÷ old CPI × 100; growth = change in real GDP ÷ old real GDP × 100.
- **Deflation** (falling prices) can be harmful, because people delay buying, so demand and jobs fall.

Exercises 2.1·2.3

2.1 Define the term *supply-side policy*. [2]

2.2 Identify two supply-side policies. [2]

2.3 State one weakness of supply-side policy. [1]

Exercises 2.1·2.3

2.1 Define the term *supply-side policy*. [2]

2.1

- **supply-side policy** aims to raise how much the economy can produce by improving the **quantity and quality of factors** (K)

2.2 Identify two supply-side policies. [2]

2.2

- any **two** of: **education and training** / **privatisation** / **deregulation** / **lower-tax incentives** (K, K)

2.3 State one weakness of supply-side policy. [1]

2.3

- it works **slowly** (results take years) (K)

Exercises 3.1·3.2

3.1 Which is a **supply-side** policy? [1]

- [ ] **A** raising interest rates
- [ ] **B** spending on education and training
- [ ] **C** raising income tax
- [ ] **D** cutting government spending

3.2 Explain how spending on education and training can raise an economy's output. [4]

Exercises 3.1·3.2

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3.1 B

- spending on **education and training** is a supply-side policy (K)
- A is monetary; C and D are fiscal demand-side tools

3.2 Explain how spending on education and training can raise an economy's output. [4]

3.2

- education and training give workers **better skills** (K)
- they become more **productive** (each makes more) (An)
- the economy can produce more → **output and capacity rise** (An)

Exercise 3.3

3.3 Analyse why supply-side policy can raise growth and lower inflation at the same time. [6]

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3.3

- supply-side policy raises **productive capacity** (K)
- the economy can make more → **growth rises**, and more supply **holds prices down** (An)
- unlike demand-side policy, it can raise growth **and** lower inflation together – but it works **slowly** (An)