Exercise walk-through

Supply-side policy ▪ 5.4

eXercise

You must be able to

- define supply-side policy and give market-based and interventionist examples
- show its effect on LRAS
- analyse its strengths and weaknesses

Method — Raising productive capacity

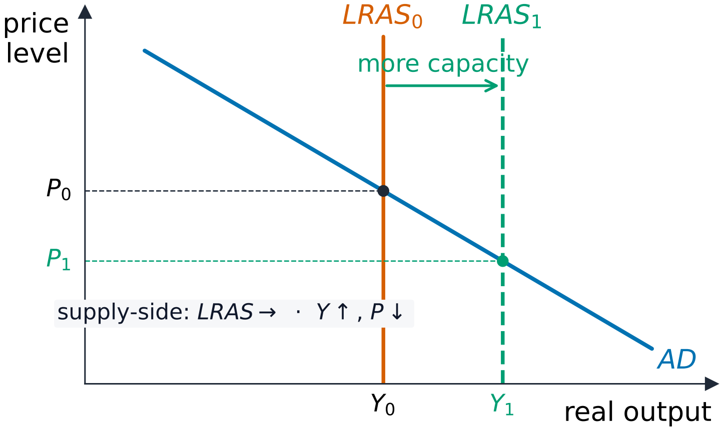
*Growth **and** lower inflation — no trade-off*

- **Supply-side policy 供给侧政策** raises **productive capacity 生产能力** (shifts LRAS right).
- **Market-based:** cut income tax/benefits (work **incentive 激励**), **privatisation 私有化**, **deregulation 放松管制**.
- **Interventionist:** education/**training 培训**, **infrastructure 基础设施**, support for research.

*On AD–AS: supply-side success raises real output **and** lowers the price level — no inflation trade-off*

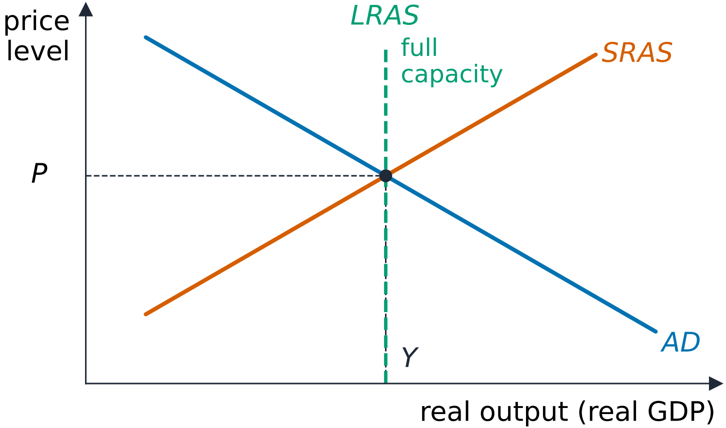
Answer shapes: an **Explain [up to 8]** answer may use an LRAS diagram (AO3); **Discuss [12]** adds a judgement (AO4).

Method — Raising productive capacity



Supply-side policy shifts LRAS right: more output and a lower price level

Method — Raising productive capacity



Unlike demand policy, an LRAS shift raises output without raising the price level

Practice 2.1 ▪ 2 marks

Define the term *supply-side policy*.

Solution 2.1

Method: Raising productive capacity

Worked steps

policy that aims to raise the economy's productive capacity by improving how markets work and raising productivity (shifting LRAS right) (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

State one market-based and one interventionist supply-side policy.

Solution 2.2

Method: Raising productive capacity

Worked steps

market-based: cut income tax / privatisation / deregulation; interventionist: education and training / infrastructure / research support $(1 + 1)$.

Practice 2.3 ▪ 1 mark

State the effect of a successful supply-side policy on LRAS.

Solution 2.3

Method: Raising productive capacity

Worked steps

LRAS shifts to the right (1).

Exam-style 3.1 ▪ 1 mark

Which is a **market-based** supply-side policy?

A government spending on training

B building new infrastructure

C privatising a state-owned firm

D raising unemployment benefits

Solution 3.1

Method: Raising productive capacity

A government spending on training

B building new infrastructure

C privatising a state-owned firm ✓

D raising unemployment benefits

Worked steps

C. Privatisation is a market-based supply-side policy.

Exam-style 3.2 ▪ 8 marks

Using a diagram, explain how investment in education and training can raise an economy's productive capacity.

Solution 3.2

Method: Raising productive capacity

Worked steps

[8] AO1 1 + **AO3 diagram up to 4** (LRAS shifts right; price level falls, output rises) + AO2/AO3 up to 3 — training raises workers' skills → higher productivity (output per worker) → the economy can produce more → LRAS shifts right, giving higher output and lower prices.

Exam-style 3.3 ▪ 12 marks

Discuss whether supply-side policy is the best way to achieve long-term economic growth.

Solution 3.3

Method: Raising productive capacity

Worked steps

[12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **For:** supply-side policy can raise growth *and* lower inflation with no trade-off, and improves long-run capacity. **Against:** it is slow (education pays off over years), costly, uncertain, and some measures (cutting benefits) widen inequality; demand must also be strong enough to use the extra capacity. Judgement: supply-side policy is the most effective route to *sustained* growth, but works best combined with demand-side support — its success depends on time and how well it is targeted.