

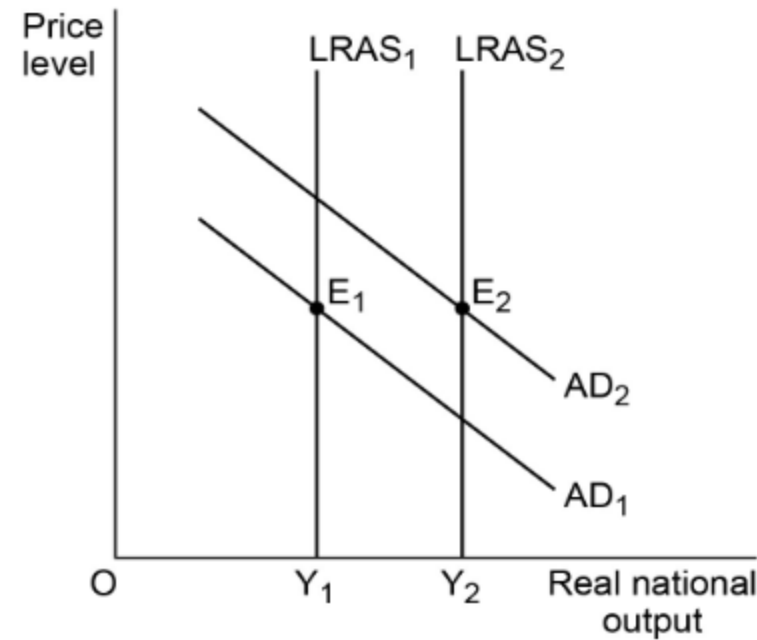
# Supply-Side Policy

*Multiple-Choice and Essay Questions from Edexcel/AQA Past Papers*

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A-LEVEL ECONOMICS

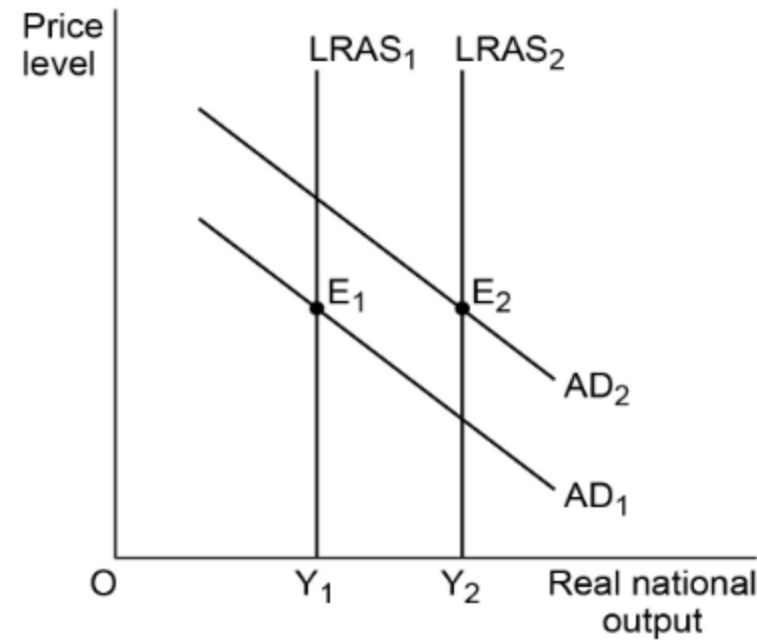
The diagram below shows two aggregate demand curves (AD) and two long-run aggregate supply curves (LRAS) for an economy. The economy's initial equilibrium point is at  $E_1$ .



All other things being equal, which one of the following combinations of macroeconomic policies, **A**, **B**, **C** or **D**, is most likely to have moved the economy to its new equilibrium point at  $E_2$ ?

	Monetary policy	Fiscal policy	
<b>A</b>	Increase in interest rates	Increase in Value Added Tax (VAT)	<input type="radio"/>
<b>B</b>	Reduction in interest rates	Reduction in direct taxes	<input type="radio"/>
<b>C</b>	Increase in interest rates	Reduction in Value Added Tax (VAT)	<input type="radio"/>
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Which one of the following statements relating to the use of supply-side policy is correct?

- A** Supply-side improvements in the economy can only be brought about by government policy.
- B** Supply-side policies are intended to increase the long-run trend rate of economic growth.
- C** Supply-side policies are designed to reduce the size of a negative output gap.
- D** Supply-side policies ensure increased capacity utilisation in the economy.

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Which one of the following is most likely to lead to a supply-side improvement in an economy? An increase in

A innovation by firms.

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B the availability of imports.

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C government spending on welfare benefits.

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D company taxation to reduce the government's budget deficit.

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Which one of the following is most likely to improve the supply-side performance of an economy? An increase in

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**B** growth in the rest of the world.

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**C** labour productivity.

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**D** the basic rate of income tax.

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Which one of the following would be most likely to generate growth in an economy without producing an increase in inflation?

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**B** An increase in labour productivity

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**C** An increase in the budget surplus

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A government wants to increase the economy's rate of long-run economic growth by implementing a supply-side policy. Which one of the following is a government policy aimed at stimulating the supply side of the economy?

**A** A new scheme to help young people buy their own homes

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**B** Greater provision of care homes for the elderly

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**C** Measures to promote competition between businesses

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**D** More generous welfare benefits for unemployed workers

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A country has a slow rate of growth of productivity and rising cyclical unemployment. All other things being equal, which measures are most likely to increase the rate of growth of productivity and reduce cyclical unemployment?

**A** Increased investment and increased saving

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**B** More government spending on training and a higher exchange rate

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Which one of the following is an example of a supply-side policy rather than a demand-side policy?

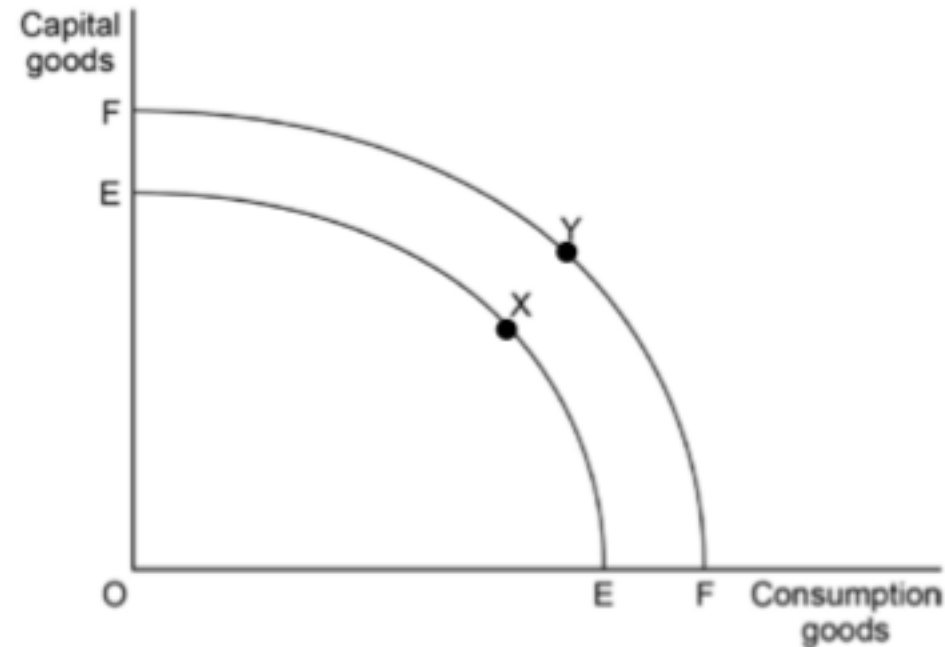
- A An increase in the supply of money. ☐
- B Increased government expenditure on welfare benefits. ☐
- C An increase in export subsidies. ☐
- D Increased government expenditure on education and training. ☐



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The diagram below shows two production possibility frontiers for an economy. The economy is initially producing at point X on production possibility frontier EE.



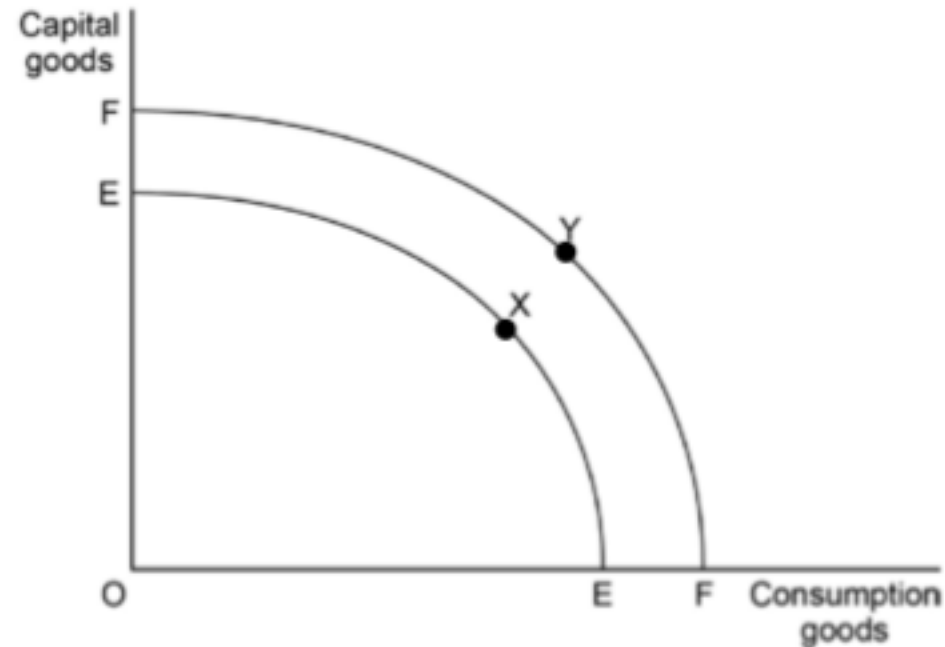
The outward movement of the production possibility frontier from EE to FF, with increased production of both types of good at point Y, is most likely to be the result of

- A a decrease in unemployment in the economy.
- B the implementation of supply-side policies.
- C an increase in the rate of inflation.
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[1 mark]

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- 4 The UK Government is planning to cut the rate of corporation tax on all pre-tax profits of companies to 17% by 2020.

(Source: adapted from <https://www.ft.com/content/7579f124-5742-11e7-9fed-c19e2700005f>)

(a) This would be an example of:

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- ☐ **A** a contractionary monetary policy
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- ☐ **C** an expansionary monetary policy
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# Essay Questions

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GCE A-LEVEL ECONOMICS

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**Extract C** (lines 2–3) states ‘More recently, India has begun to use more market-based strategies to help its development, including liberalising trade and privatisation.’

Using the data in the extracts and your knowledge of economics, evaluate the view that greater use of market-based strategies is the best way to improve the economic development of India.

**[25 marks]**

## Extract C: 'Make in India' – the road to development?

India has steadily opened up its economy and reduced regulations that have sometimes held it back. More recently, India has begun to use more market-based strategies to help its development, including liberalising trade and privatisation. These may be risky strategies as India lacks the infrastructure that most of its global competitors have. 1

Trade reforms do appear to have produced remarkable results. India's trade, as a percentage of GDP, has increased from 15% to 40% between 1990 and 2014, and the economy is now among the fastest growing in the world. In more recent years, the Indian government's stand on trade and investment policy has displayed a shift from protecting producers to benefiting consumers. 'Make in India' is an initiative to encourage multinational companies to manufacture their products in India and shift Indian employment from the unstable primary sector to the secondary sector. 5 10

Recently, there has been a promise by foreign companies to invest \$222 billion in India. When foreign companies come to a 'Make in India' event, they see an economy that is growing at 7% annually with a large well-educated and skilled workforce. However, problems persist with regulation and tax. In the World Bank's Doing Business Index, which indicates how easy it is to set up and run a business, India is ranked 130<sup>th</sup> out of 189 countries. The question still remains, is the road to a more developed India one which involves the free market and liberalisation of trade, or one which involves government intervention and protectionism? 15



**Areas for discussion include:**

- definitions/explanations: economic development, market-based strategies, interventionist strategies
- differences and links between economic growth and economic development
- examples of market-based strategies such as privatisation, deregulation, liberalisation of foreign trade, removing restrictions on international investment
- examples of interventionist strategies such as government spending on infrastructure, protectionist policies and government spending on health and education
- the pros and cons of market-based approaches to achieving development
- the pros and cons of interventionist approaches to achieving development
- difficulties in measuring development in terms of economic/human development
- the potential barriers that may hinder India's development
- analysis of the impact of development on formal employment/informal employment
- the progression from the primary sector to secondary sector employment
- whether growth and development are sustainable
- economic/social/political freedom arguments
- costs of development and/or growth and their impact on living standards
- the effectiveness of policies that might stimulate development
- protectionism as an aid to development
- the role of investment (domestic and foreign direct)
- key industries in development.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

- (e) Discuss 'looser fiscal policy' and 'supply-side reforms' (Extract A, lines 20 and 21) that may be used by governments of Eurozone countries to increase economic growth.

(15)

**European Central Bank disappoints markets with weaker than expected stimulus**

Mario Draghi, president of the European Central Bank (ECB), surprised financial markets in November 2015 with a less ambitious package of monetary stimulus than many had anticipated.

The ECB cut its base interest rate by 0.1% to minus 0.3% in order to encourage private banks to lend funds to companies and households rather than deposit them at the central bank. The central bank agreed to extend its €60 billion (£45 billion) monthly bond-buying quantitative easing (QE) programme for a further six months. The ECB's €1.1 trillion QE scheme had originally been due to end in September 2016. 5

"We are doing more because it works," Mr Draghi said. Yet the ECB did not increase the size of its monthly asset purchases and also disappointed those expecting that it would cut interest rates more aggressively. 10

The euro rose almost 3% against the dollar to \$1.08 after the announcement. Italian and Spanish bond yields both jumped by 0.27% to 1.62% and 1.72% respectively.

The ECB's economists reduced their inflation forecasts for the next two years. They now predict consumer prices in the Eurozone rising by just 1% in 2016 and 1.6% in 2017 – still below the central bank's ceiling of 2%. In November 2015, the inflation rate was just 0.1% and core inflation, excluding volatile items such as fuel and food, dropped to 0.9%. 15

Mr Draghi stressed again that monetary policy alone could not restore the Eurozone to economic health. He called for looser fiscal policy among member states to support aggregate demand and more rapid implementation of supply-side reforms. "In order to reap the full benefits from our monetary policy measures, other policy areas must contribute decisively," he said. 20

Question Number	Indicative content	Mark
<b>6(e)</b>	<p><b>Knowledge 3, Application 3, Analysis 3</b></p> <p><b>Potential policies may include:</b></p> <ul style="list-style-type: none"> <li>• Fiscal policies, e.g. reduced corporation tax to increase investment and therefore increase AD</li> <li>• Supply-side policies, e.g. increased investment in education to create a more highly-skilled and therefore more productive workforce</li> </ul> <p>N.B. Candidates may discuss more than one of each type of policy</p> <p>N.B. Candidates must discuss both fiscal and supply-side policies for level 3</p>	<b>(9)</b>

Question Number	Indicative content	Mark
<b>6(e)</b> continued	<p><b>Evaluation 6</b></p> <p>Evaluation of the policies, e.g.</p> <ul style="list-style-type: none"> <li>• Governments in many Eurozone countries are having to focus on reducing national debt and can't afford policies such as tax cuts</li> <li>• Supply-side policies take a long time to have an impact on the economy</li> </ul>	<b>(6)</b>

0	6
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**Extract F** (lines 4–6) states: ‘some are now arguing that further improvements in the unemployment statistics can only be gained through improvements in the supply-side of the economy, rather than relying on demand.’

To what extent do you agree that a further reduction in the UK’s unemployment rate is most likely to be achieved by improvements in the supply-side rather than the demand-side of the economy? Use the data and your own knowledge of economics, to justify your answer.

**[25 marks]**



## Extract F: Unemployment in the UK – as good as it gets?

The UK labour market is showing some healthy signs. A significant number of new jobs are continuing to be created and the unemployment rate stood at 5.7% at the end of 2014, in comparison to a Eurozone average of 11.1%. Economic growth has increased the demand for labour. However, some are now arguing that further improvements in the unemployment statistics can only be gained through improvements in the supply-side of the economy, rather than relying on demand.

1

5

Wages are growing at their highest rate for over three years and inflation is at its lowest level on record. Consumers are in a much stronger position and the prospects for the UK economy have improved. At the same time, some European economies are showing signs of growth, which is likely to boost UK exports. However, further efforts to reduce the unemployment rate may prove difficult. Some argue that there are jobs out there, but some people are not willing or able to take them.

10

Labour market programmes are in place in the form of training, subsidies for private employers and help for individuals to find work. However, the UK government has also embarked on a number of policy changes in an attempt to force the unemployed back to work and to deal with the rising costs of welfare. Measures such as the creation of the benefits cap (which limits the maximum amount that people of working age can receive in benefits) and restricting the uprating of Jobseeker's Allowance to the rate of inflation or 1% (whichever is lower) are all part of an attempt to encourage the unemployed to seek work. However, some would say that this is punishing the unemployed. The announcement of the introduction of a National Living Wage in the recent budget is claimed by the government to offset the effect of the changes to the benefits system.

15

20

Analysis	<p><b>Arguments as to why demand-side factors may cause further falls:</b></p> <ul style="list-style-type: none"> <li>• Rising real incomes in the UK</li> <li>• Increased confidence</li> <li>• Possible increases in domestic investment</li> <li>• Possible increases in FDI</li> <li>• Multiplier effects</li> <li>• Improved export opportunities (if the EU grows)</li> </ul> <p><b>Arguments as to why supply-side factors may cause further falls:</b></p> <ul style="list-style-type: none"> <li>• Consideration of the “voluntary” nature of some types of unemployment</li> <li>• Changes to incentives</li> <li>• Changes to benefits forcing people into low paid jobs</li> <li>• Consideration that living wage may actually entice more people into jobs market</li> <li>• So called “carrot and stick” approaches</li> <li>• Changes to structural unemployment</li> <li>• Improvements to mobility (occupational and geographical)</li> <li>• The UK’s experiences under the “Work Programme” and government policy</li> <li>• Focus on particular groups, such as the 16-24 age group or the long term unemployed.</li> </ul>
Evaluation	<ul style="list-style-type: none"> <li>• The UK could be approaching NRU/NAIRU/full capacity, the supply-side may be vital in order to gain further improvements</li> <li>• Both approaches are not mutually exclusive, improvements could be made on both at the same time</li> <li>• Some factors may be beyond the control of the UK, eg external demand in the EU, is trade a significant issue?</li> <li>• Consideration of regional aspects – unemployment rates mask a regional issue which is very difficult to solve with policies which aren’t targeted</li> <li>• Consideration that more jobs may be created but the incomes or conditions provided by those jobs maybe are not as good as others</li> </ul> <p><i>Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.</i></p>
Also give credit for	<ul style="list-style-type: none"> <li>• Reference to the UK/other economies</li> <li>• Diagrams</li> <li>• An overall judgement on the issues raised.</li> </ul>

Introduction	<ul style="list-style-type: none"> <li>• Unemployment</li> <li>• Demand-side/Supply-side</li> <li>• Types of unemployment</li> </ul>
Developing the response to the question (Application)	<p>Drawing on information in the extracts:</p> <ul style="list-style-type: none"> <li>• Labour market reforms (<b>Extract E and Extract F</b>)</li> <li>• EU possibly recovering (<b>Extract E and Extract F</b>)</li> <li>• Supply-side reforms (<b>Extract E</b>)</li> <li>• Effects on firms/workers (<b>Extract E</b>)</li> <li>• Comparisons with other EU countries (<b>Extract E</b>)</li> <li>• The current state of the UK labour market and wage growth (<b>Extract F</b>)</li> <li>• Subsidies/training/introduction of living wage (<b>Extract F</b>)</li> <li>• Benefits cap and limiting JSA (<b>Extract F</b>)</li> </ul>