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# Supply-Side Policies

GCE A-LEVEL & IB ECONOMICS

# Lesson Structure

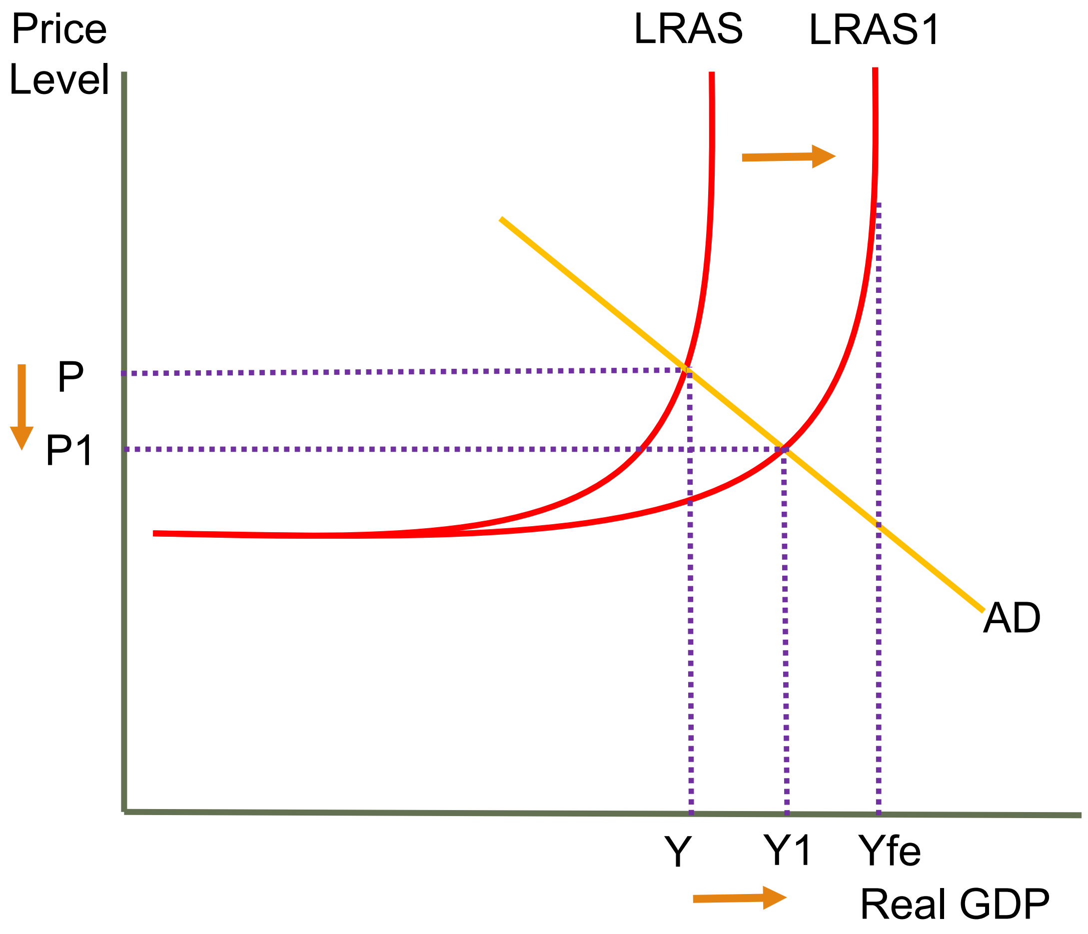
## Supply-side Policies

- Market-Based Supply-Side Policy
- Interventionist Supply-Side Policy
- AD/AS Diagrams to illustrate Supply-Side Policies
- Evaluating Supply-Side Policies

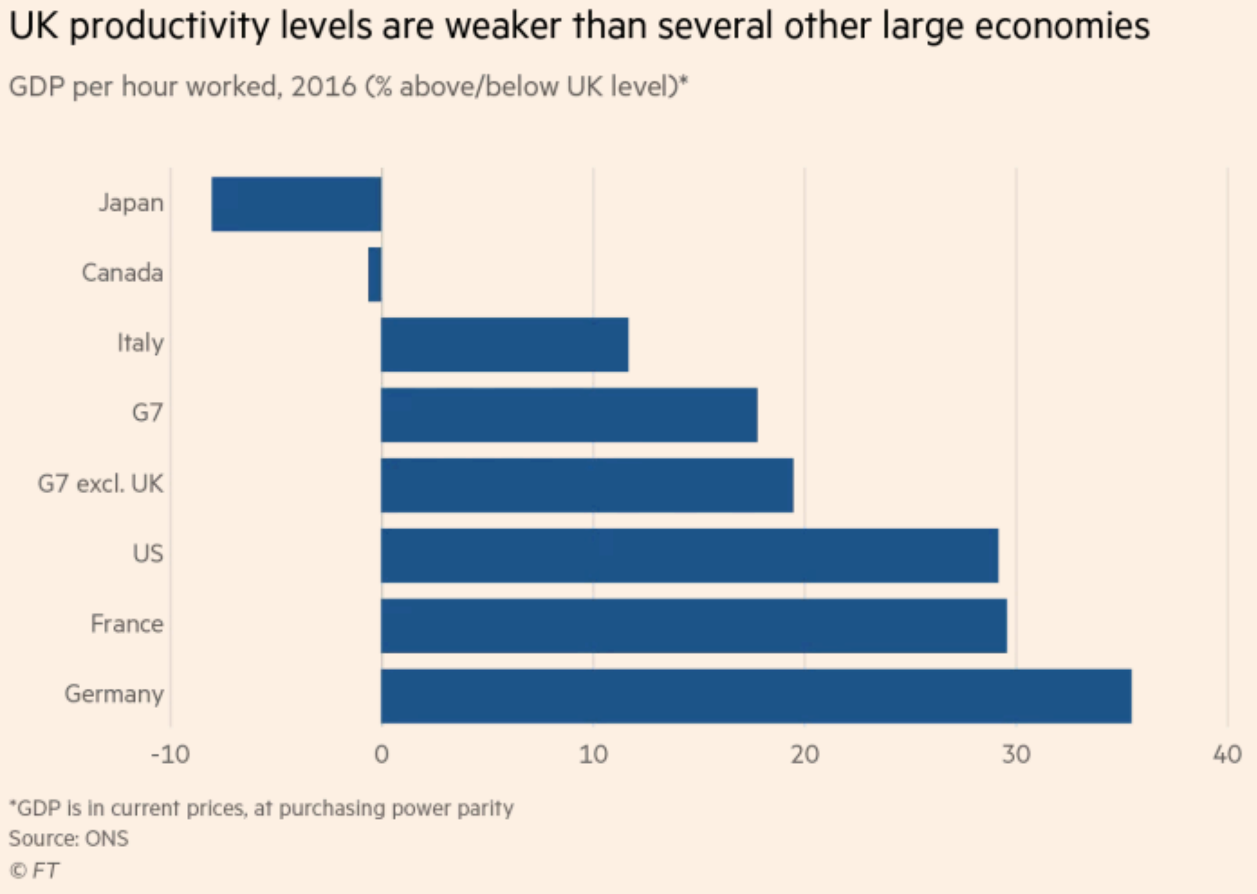
# Supply-Side Policies

Supply-side policies aim to increase the aggregate supply of the economy by increasing economic productivity or improving market efficiency.

An increase in the productive capacity of the economy (LRAS) will decrease price level (inflationary pressures) in the economy and cause economic growth. This also corresponds to an increase in real GDP and a shift outward of the PPF.



# UK's Productivity Crisis




*"The average German worker produces more in four days than a British equivalent does in five" Telegraph, 2018*

# Improving Factors of Production

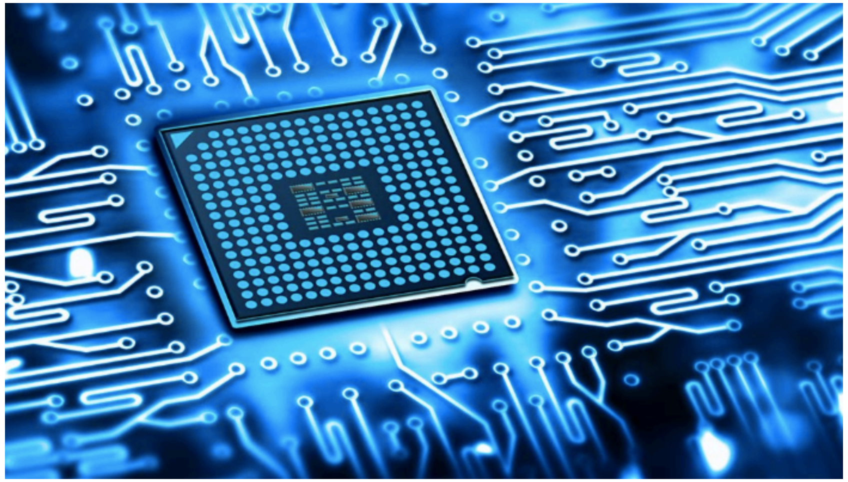
A big focus of supply-side policies is to improve factors of production to increase productive capacity.




# Interventionist Supply-side Policy

Supply-side policies aiming to improve infrastructure, labour and technology through government investment to boost economic productivity.

Fundamentally, these policies involve government investment to improve our factors of production.



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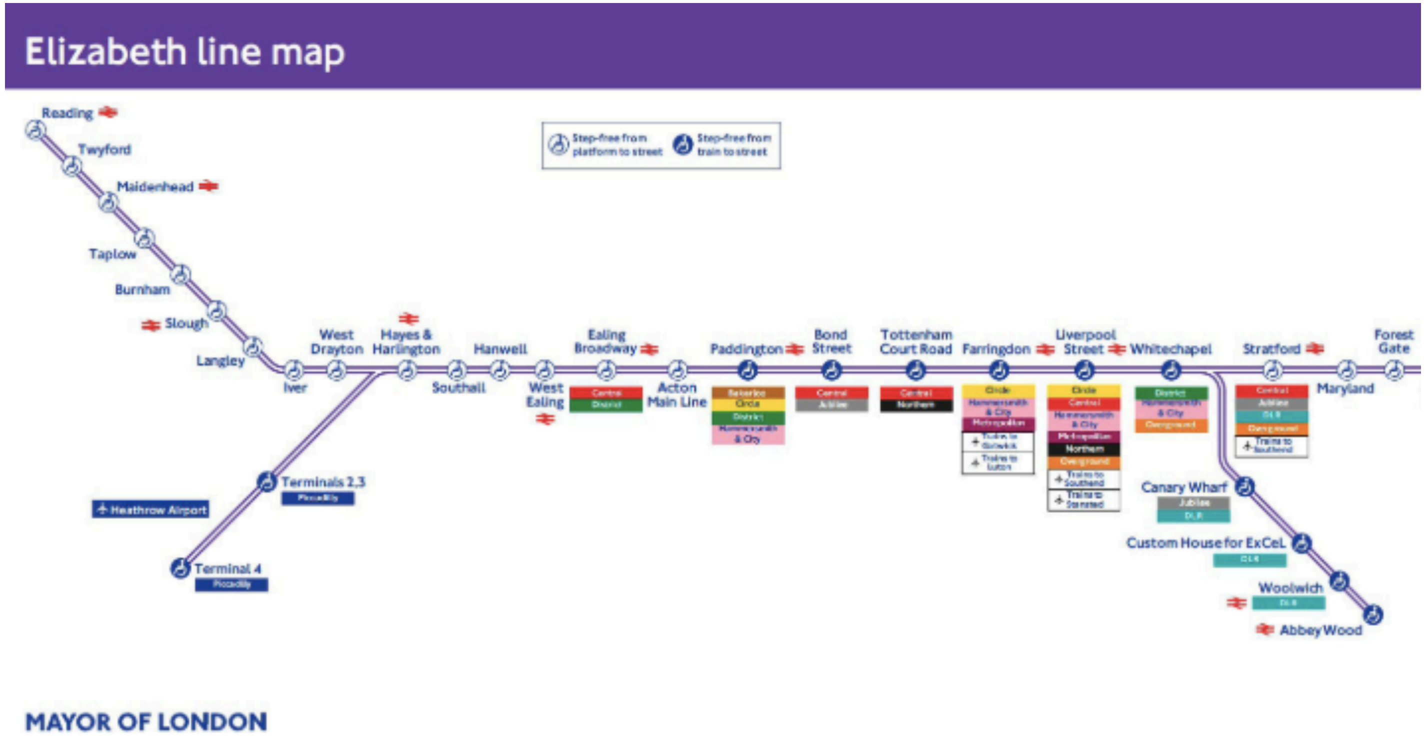
# Types of Infrastructure

Infrastructure are fundamental facilities and systems that help provide basic needs for an economy to function.

They tend to be publicly owned, provided or subsidized, and is a type of capital that helps us produce goods and services.

**Utilities, Transportation, Telecommunications**

# Infrastructure – Elizabeth Line




*"The new railway will bring an extra 1.5 million people to within 45 minutes of Central London"*

# Interventionist Supply-side Policy

## Investment in Infrastructure

- Better transportation, telecommunications and energy provision increases firm productivity and reduces cost to produce
- New business opportunities allow more companies be set-up in various industries (e.g. manufacturing/logistics companies)

## Investment in Technology

- More efficient capital machinery can be used to produce more goods and increase output
- Technology tend to generate positive production externalities and spark further innovation

# Interventionist Supply-side Policy

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**Investment in Human Capital**

- Better education and labour training will increase the skills and productivity of workers
- Furthermore, training reduces occupational immobility, thus increasing labour demand, employment and output.

Note that these investments may increase AD slightly in the short term before shifting AS, due to higher government spending and investment.

# Market-Based Supply-side Policy

Supply-side policies that reduce government involvement in the free market to increase market efficiency. This is possibly done by providing incentives or encouraging market competition.

For example, by reducing income tax, it would mean...

Individuals more incentivized to work → Higher supply of labour → Bigger labour force → Increase Factors of production → Increase in AS and potential output (GDP)

# Market-Based Supply-side Policy

**Labour market reforms**

- Reduce unemployment benefits and power of labour unions to increase labour market mobility and size of labour force

**Incentive related policies**

- Reduce income, corporation and capital gains tax to increase incentive to work, produce goods/services and invest in new capital

**Industrial/regional policies and Investment Grants**

- Promote growth in key industries by tax cuts/allowances or subsidized lending to increase LRAS

# Market-Based Supply-side Policy

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## Policies encouraging (free-market) competition

- Deregulation can reduce barriers to entry into markets, reducing market power and allow more firms to enter and compete. AS will increase with more firms producing goods and services in various markets.

- Privatization can reduce public-sector inefficiencies. Privatizing firms giving companies a profit incentive to keep costs low, raise productivity and compete in the free market. This will increase supply and market efficiency.

# Supply-Side Policy Advantages

- Increases Real GDP with Limited Trade-off
  - Compared to demand-side policies, supply-side policies are disinflationary but increases output.
- Reduces Natural Unemployment Rate
  - Labour market reforms reduce frictional unemployment, and investment in human capital reduces structural unemployment. This decreases the long run natural unemployment rate.
- Improves International Competitiveness & Current Account
  - By investing in productivity through technology, human capital & infrastructure, this will reduce production costs and make domestic producers more competitive. This can potentially have a positive impact on the current account.
- Long Term Solution/Impact
  - Supply-side policies have a positive effect on the economy in the long run by addressing structural issues, rather than temporary output boosts in demand-side policy

# Supply-Side Policy Problems

- Time lag
  - Investments to increase productivity can take years (e.g. education/training), although incentive-based policies may work faster (e.g. tax cuts)
- Effects on Equity
  - Capital gains and income tax are progressive, meaning tax cuts are likely to benefit the wealthy more. Furthermore the fall in government revenue and welfare support will also affect disadvantaged households, making the distribution of income less equitable.
- Exploitation of Workers
  - By reducing/removing min. wage, labour union power and worker rights can easily lead to exploitation of workers by firms, even though more of them may be employed.
- Diminishes Government Budget
  - Investment in human capital, technology and infrastructure combined with tax cuts & subsidies will reduce the government budget significantly. Meaning some spending now must be given up.

# Evaluating Supply-Side Policy

- Gov. Budget & Opportunity Cost
  - Any government spending that needs to be given up for investing (e.g. infrastructure) should be considered. It may also be unwise to invest if the government is in significant debt.
- Current Distribution of Income / Equity
  - If income inequality is high, then the government may consider other policies
- Timeframe
  - Given investment in capital or particular industries may take years, timing should be an important consideration as the investment may become obsolete by completion.
- Extent of Market Failure
  - Effectiveness of market-based policies depends on the level of inefficiency in the market caused by labour unions, labour legislation and monopolies.