

Supply Side Policies: 6 ways to shift LRAS

Webnote 260

Syllabus Items: 124 -132

1. Reduce marginal tax rates
2. Reduce welfare payments for the unemployed
3. Encourage entrepreneurship
4. Reform labour legislation
5. Privatisation
6. Competition policy

See webnotes:

261 262 263 264

Syllabus items:

124 -132

Syllabus

Weighing: 5

Reading in Blink:

187 - 190

Big Idea
1

Big Idea
2

Big Idea
3

Big Idea
3

Diagram A: Aggregate Demand / Aggregate Supply Model



Webnote 260 Big Ideas for Supply
Side Policies

2.6 Supply side policies: Key terms

2.6 - Supply-Side Policies (LRAS)

- interventionist based supply side policy
- market based supply side policy
- supply side policy

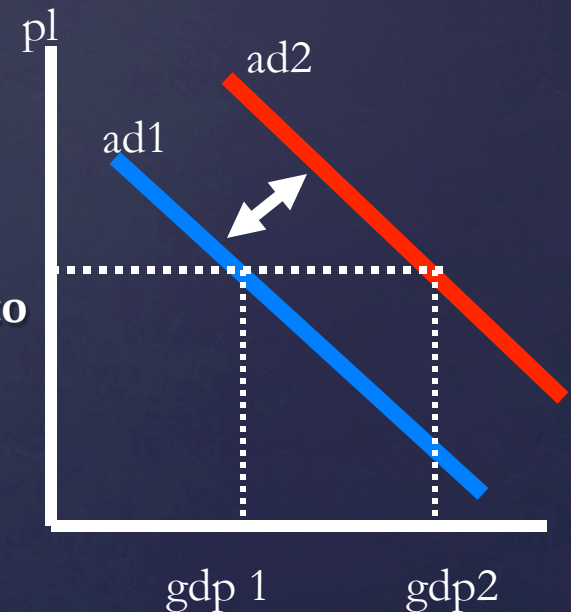
Diagram A: Aggregate Demand / Aggregate Supply Model



REVIEW syllabus 2.2: 5 factors cause a Shift in AD? $AD = C + I + G + (X - M)$

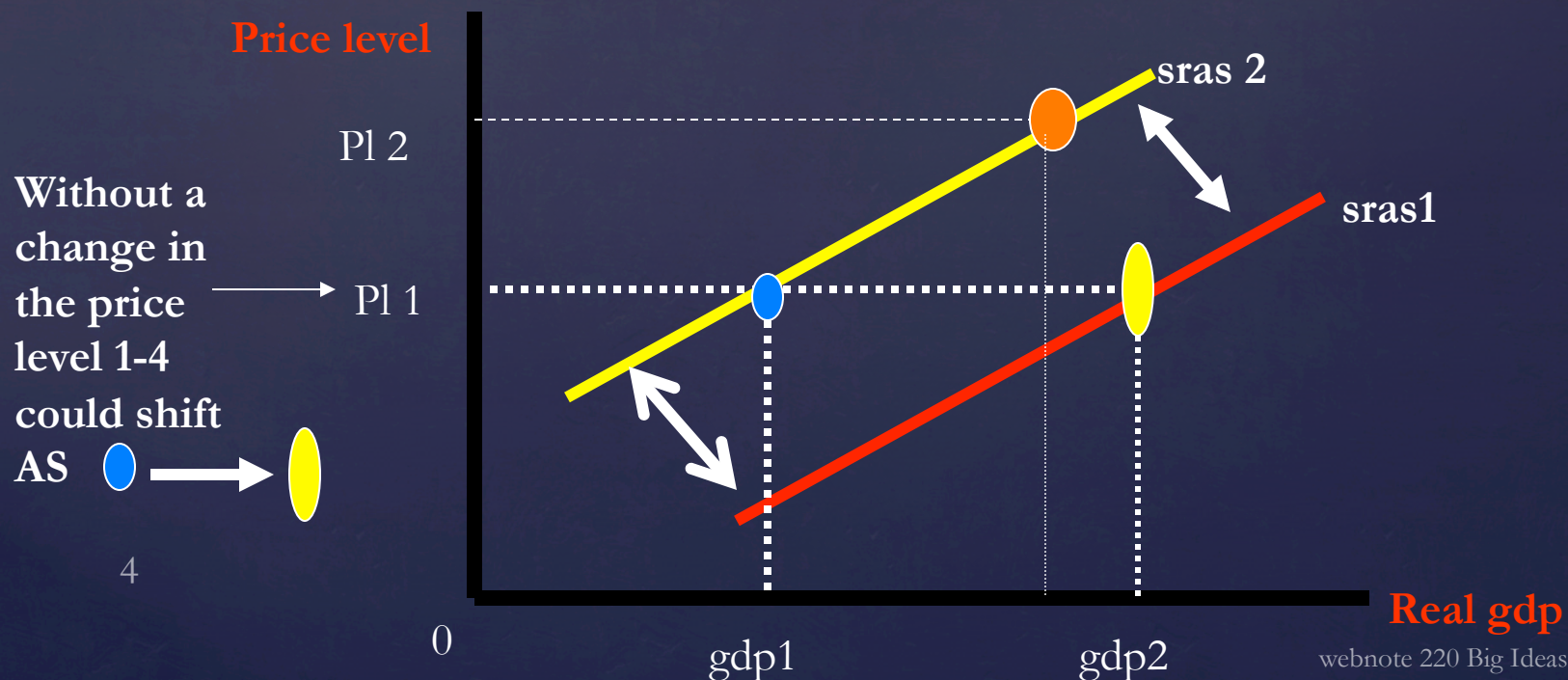
Factors that impact AD...

1. Fiscal policy- e.g. + or – in direct taxes change Consumption or Investment
2. Monetary policy- +or- in interest rates leading to changes in C and I
3. Foreign income changes (more X)
4. Expectations www.ifo.de (consumer and business confidence)



REVIEW syllabus 2.2 4 factors that causes **SRAS** to shift ?

1. **WAGES**: rise or fall
2. **RAW MATERIALS**: costs of inputs rise or fall (e.g. oil)
3. **IMPORTS**- rising import prices cause sras to shift from sras 1 to sras 2.
4. **TAXES+SUBSIDIES**: both affect ability of firms to produce



IBQ

IB Unit 2.3+2.6: Unit Question
Big Question: Unemployment
HL1 2014-November

3. (a) Distinguish between structural and demand-deficient unemployment. [10 marks]

(b) Discuss the view that the problem of unemployment can be reduced through the use of supply-side policies.

(Note: a similar question could also ask you to consider connection between unemployment and demand side policies.)

N14/3/ECONO/HP1/ENG/TZ0/XX

Know the Supply Side Policies: 6 ways to shift AS

INTERVENTIONIST

1. Reduce welfare payments for the unemployed
2. Encourage entrepreneurship: merit good spending e.g. education + training
3. Reform labour legislation

Alternative focus on supply side policies:

4. See Welker clip on webpage 2.6 Infrastructure spending (public goods. See slide 9 for example.)

see Cambridge book pp 261-268

1. Research and Development funded by government
2. Provision of jobsearch centres i.e. availability of information to access work
3. Support for infant industries
4. Improvements in infrastructure (lowers cost of doing business)

MARKET BASED

1. Reduce marginal tax rates
2. Privatisation
3. Competition policy

Increase Quantity and Quality of factors of production:

Diagram A: Aggregate Demand / Aggregate Supply Model



Know how to show the interventionist vs the market based supply side policies6 Supply Side Policies

Supply side policies should be applied in the short run (sras 1 to sras 2) with the objective of shifting LRAS1 to LRAS2. See slide 9 for example

Diagram A: Aggregate Demand / Aggregate Supply Model

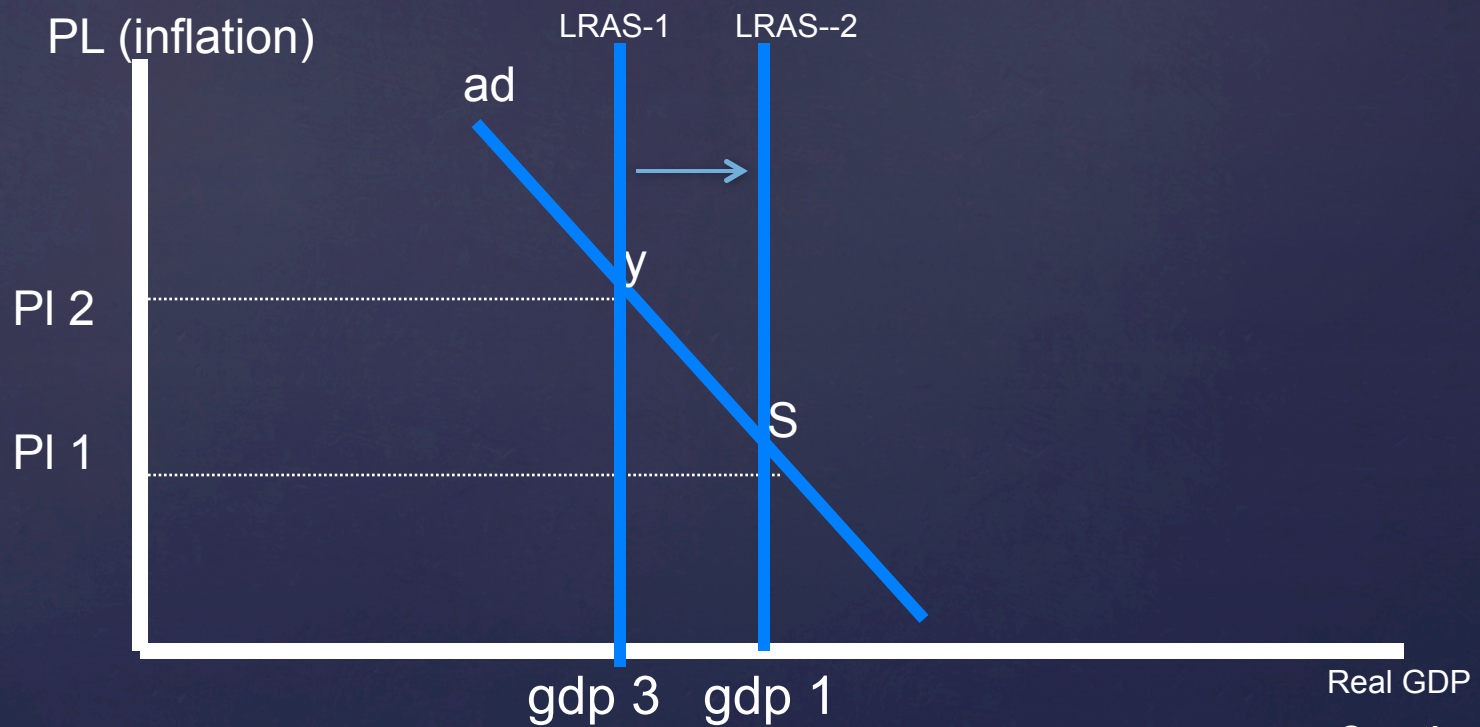


Big Idea

3

Supply side policies affect LRAS and show a higher real output and a lower price level?

Diagram A: Aggregate Demand / Aggregate Supply Model



SR + LR WORK TOGETHER TO SHIFT LRAS: interventionis supply side policy

Note: analysis starts at y

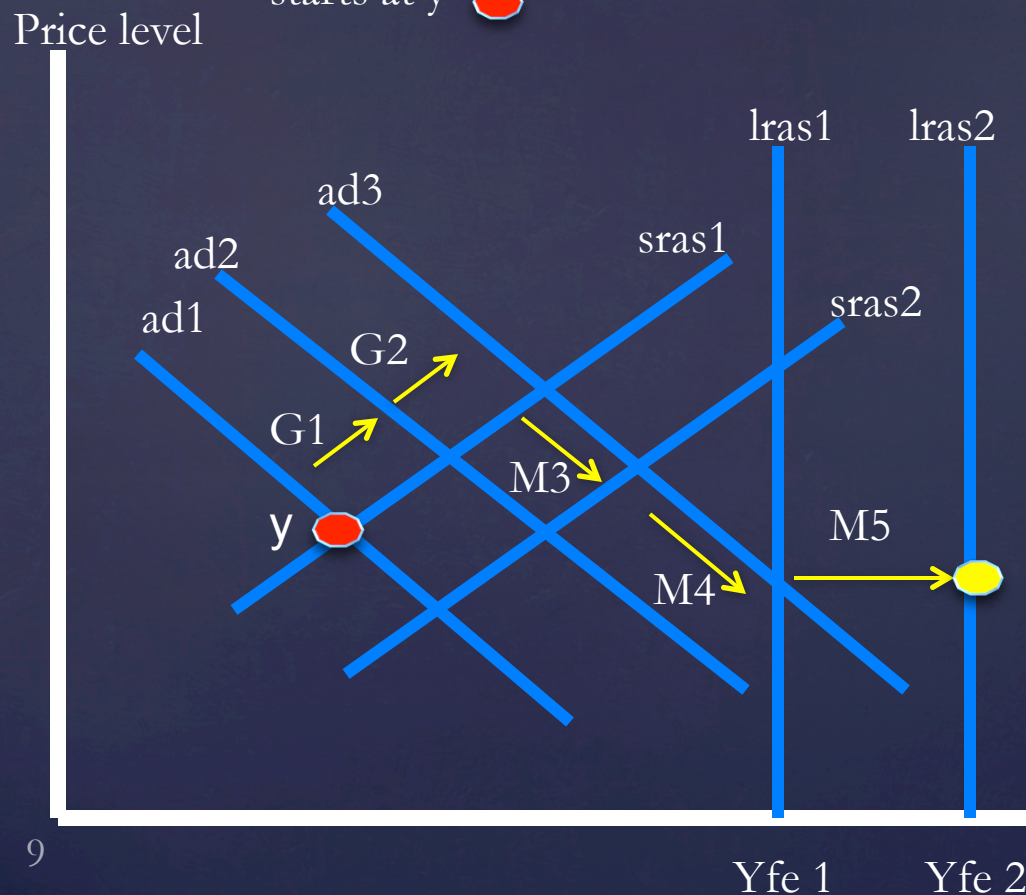
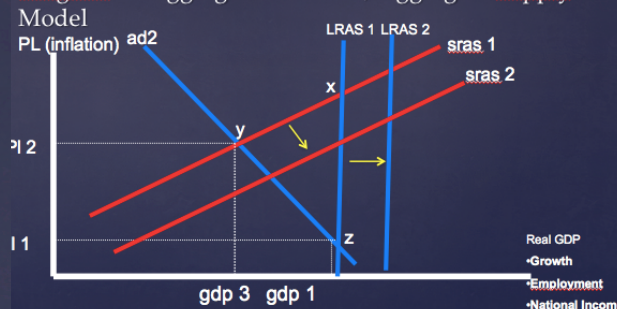


Diagram A: Aggregate Demand / Aggregate Supply Model



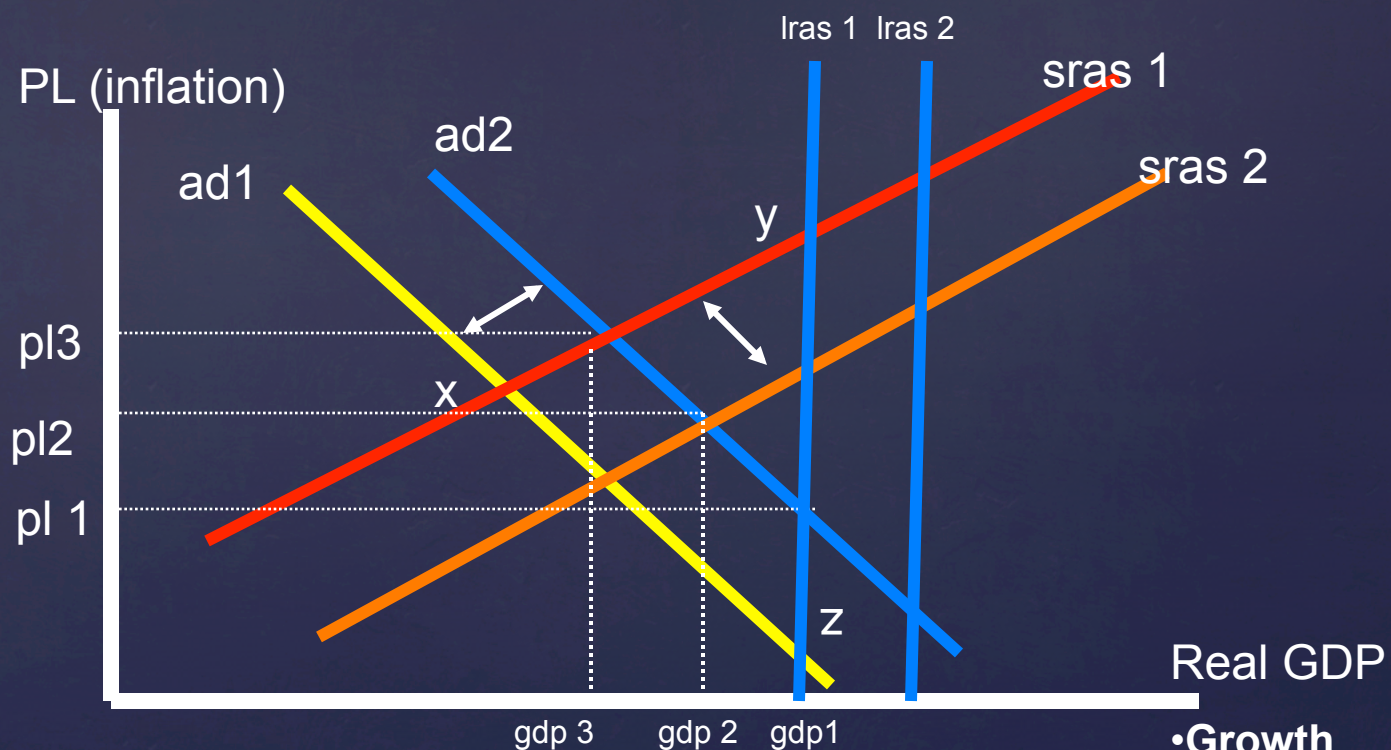
G1: government spends on education and training. AD shifts due to spending and firms benefit from a more productive workforce

G2: government spends on infrastructure. AD shifts due to spending and firms benefit from lower costs due to faster transport and a more efficient transfer of FOP and G+S.
• SRAS shifts to SRAS 2 (M3)

M3-M4-M5: markets react to intervention by government spending on education + infrastructure. Firms have lower costs and SRAS shifts downwards and as this is sustained in the long run the Q+Q of factors of production increases and the LRAS1 shifts to LRAS2 or Yfe 2.

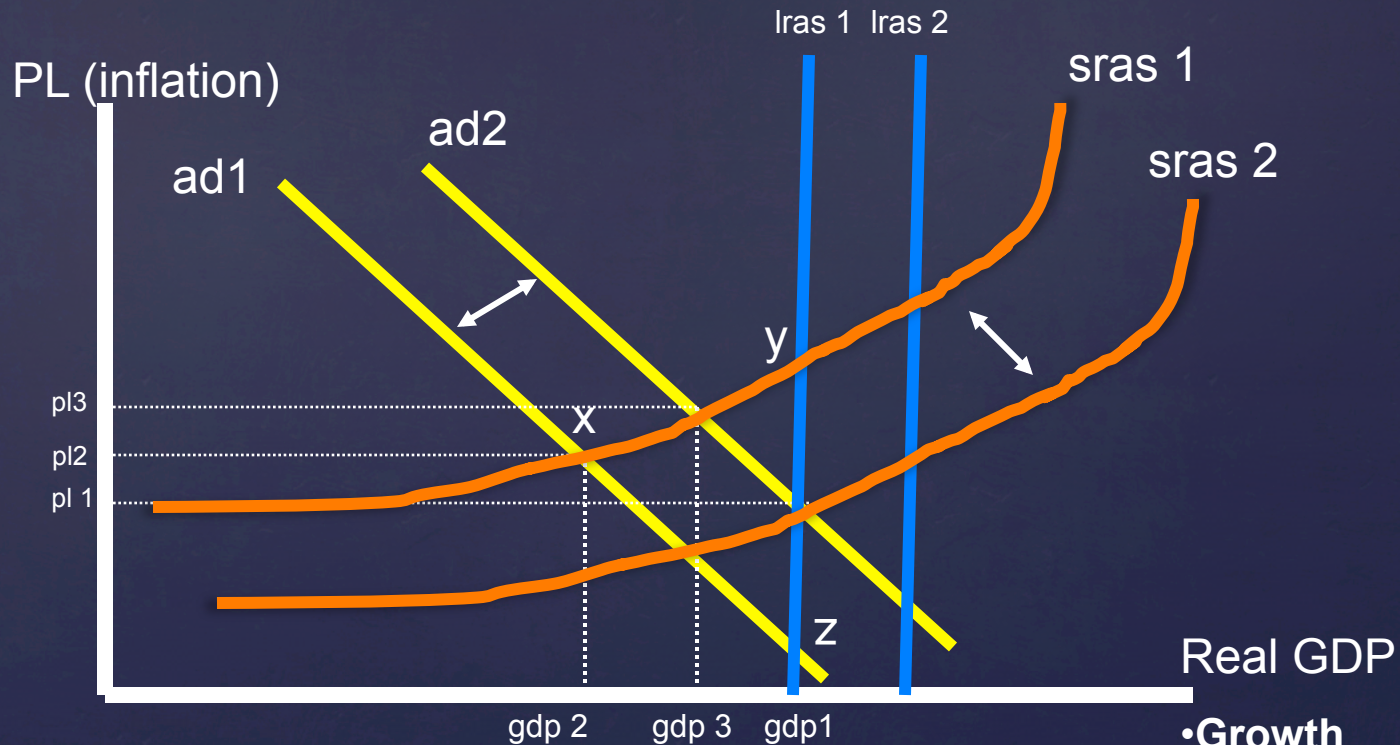
Webnote 260:6 Supply Side Policies

Diagram A: Aggregate Demand + Aggregate Supply Management to solve a recessionary problem



Webnote 260:6 Supply Side Policies

Diagram A: Aggregate Demand + Aggregate Supply Management to solve a recessionary problem



•Growth

•Employment

•National Income

Keynesian Response

more details in webnote **261**

1. Reduce marginal tax rates
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1. **no empirical evidence**
2. **increases poverty**
3. **Good! but has no significant effect on macroeconomy**
4. **" Shareholders gain from the losses of workers".**
5. **private sector corruption is a key issue**
6. **private sector needs strong regulation and has inherent weaknesses**

You decide?

more details in webnote **261**

Many Keynesians favour the use of the public sector to stimulate long term growth. Unlike monetarists, they view the private sector as often incapable of taking the correct policy decision for the well-being of the nation as a whole. In particular, they argue that the private sector may not undertake sufficient investment, that the investment that is taking place is not in the right industries, and that it is not in the right geographical regions. Pro Government role / markets inherently weak and do not reach equilibrium easily.

You decide?

more details in webnote **261**

Keynesians favour direct government action to remedy these defects. Either firms can be given tax incentives or the state can give more grants. A more radical solution to the problem is for the state to invest on its own behalf, building up state-owned firms i.e. a policy of nationalization of industry although this approach is no longer common in DC's as most have established policies of privatization of state owned enterprises.

You decide?

more details in webnote **261**

Monetarists argue that the state is incapable of managing investment wisely. Only the private sector can direct investment resources efficiently. If governments insist on pumping state aid into dying industries or industries in regions that are in decline economically, then yet more scarce resources are going to go down the public sector drain. Pro Market approach to management of the economy. Market allocation works well and less government interference in terms of resource allocation is advised.