

OCR Economics A-level

Macroeconomics

Topic 3: Implementing Policy

3.3 Supply Side Policy

Notes

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Supply-side policies aim to improve the long run productive potential of the economy. This increases the quantity or quality of the factors of production. On a diagram, successful supply side policies should shift long run aggregate supply to the right.

Privatisation and deregulation

By deregulating or privatising the public sector, firms can compete in a competitive market, which should also help improve economic efficiency. Privatisation may introduce the profit motive, encouraging firms to improve efficiency, and cut costs/improve productivity. In turn, profits earned may then be reinvested into R&D or production processes, increasing dynamic efficiency and shifting out the productive potential of the economy. Likewise, deregulation can help reduce red tape and restrictions, encouraging higher levels of competition and gains in efficiency (factors of production may be used more efficiently.)

Examples of deregulation include the rise of 0 hour contracts in the UK which enables firms to cut labour costs.

Subsidies

These could be directed towards small businesses to encourage them to expand, or to lower training costs for firms. Subsidies could also be used to encourage firms to spend in R&D or technology, which, if successful could increase the productive potential of the economy

Competition Policy

Competition policy may involve tightening of anti-cartel laws, deregulation and promotion of competition and efficiency in markets.

Infrastructure development- including consideration of transport market

Governments could spend more on infrastructure, such as improving roads and schools. This could make transport more efficient, since it will take less time and cost less to move between places. It might also contribute to the geographical mobility of labour.



Research and development incentives

This can encourage more investment, which can benefit the economy in the long run by helping firms find more efficient methods of production and innovating.

Education and training

The government could subsidise training or spend more on education. This also lowers costs for firms, since they will have to train fewer workers. It makes the quality of labour better, which results in a more productive workforce. This increases the potential output of an economy.

By improving access to training and education, it becomes more convenient for people to improve their skills, which is likely to encourage them to do so. For example, universities might use access schemes to encourage more people to apply, or apprenticeships might become more widely available.

Reforming tax and benefits, or reducing marginal tax rates

By reducing income and corporation tax, governments could encourage spending and investment.

Tax reforms could encourage more people to work, and benefits could be more stringent. They can also encourage more entrepreneurship.

Improving labour market flexibility- including consideration of the housing market

Reducing the National Minimum Wage (or abolishing it altogether) will allow free market forces to allocate wages and the labour market should clear.

Governments could try and improve the geographical mobility of labour by subsidising the relocation of workers and improving the availability of job vacancy information.

Working arrangements and contracts could be made more flexible. Examples of this include the growth of part time work and 0 hour contracts

Reducing trade union power makes employing workers less restrictive and it increases the mobility of labour. This makes the labour market more efficient.



Immigration

Migration can fill skills gaps and reduce the unemployment rate. This could result in higher productivity among the labour force.

Strengths and weaknesses of supply-side policies:

-  Supply-side policies are the only policies which can deal with structural unemployment, because the labour market can be directly improved with education and training.
-  Demand-side policies are better at dealing with cyclical unemployment, since they can reduce the size of a negative output gap and shift the AD curve to the right.
-  There are significant time lags associated with supply-side policies.
-  Market-based supply-side policies, such as reducing the rate of tax, could lead to a more unequal distribution of wealth.
-  Supply side policies such as education and training may also be highly costly to implement. The way in which these policies can be funded may then be a concern.
-  Supply-side policies could help increase productivity with increased spending on education and training, which could result in the country becoming more internationally competitive. This could lead to a rise in exports. However, this incurs a significant time lag, so it is not effective as an immediate measure. In the long term, this can be an effective policy.
-  Supply-side policies could also help make the domestic economy attractive to investors.
-  The domestic economy could be made more competitive through deregulation and privatisation, which will force firms to lower their average costs. However, privatisation could result in monopolies being formed, which will not increase efficiency.



- 📄 If governments provide subsidies to some industries to encourage production, there could be retaliation from foreign countries that see this as an unfair protectionist policy.

