

Supply side policies

What are supply side policies?

Supply side policies are government policies designed to increase the productive capacity of the economy, so shifting the LRAS curve outwards. These can be broadly categorised into:

Encouraging competition: Through privatisation of state owned assets and deregulation of industries. This happened lots during the time Thatcher was Prime Minister and most industries that have been privatised have also been deregulated. The NHS has not been privatised, although the industry regulations allow other providers of health care. Water services is probably the only example of an industry that has been privatised but not deregulated.

Providing incentives: Removing or decreasing disincentives to work such as unemployment benefits. It is debateable as to how effective decreasing benefits is at increasing participation in the work force.

Increasing competitiveness: Investment in education, research and development making the UK competitive with overseas economies.

Effects in the short run

The effects here are minimal. The government may increase its government discretionary capital expenditure as more is spent on investing. Firms may also be encouraged to increase their investment by being offered subsidies or tax relief for doing so. Therefore in the short run there may be a small increase in aggregate demand which may, if the economy is near full employment cause inflation.

Long run effects

Supply side policies aim to increase aggregate supply by increasing either the quantity or quality of the resources in the economy. Primarily this takes the form of increasing capital through investment, encouraging entrepreneurship and improving the quality of labour.

Labour: Aim primarily to increase occupational mobility through improving skills of the workforce.

- Remove trade unions.
- Reduce welfare benefits.
- Reduce minimum wage.
- Decrease tax rates on income.
- Reduce taxes on labour.
- Reduce costs of changing jobs.
- Increase training and education.

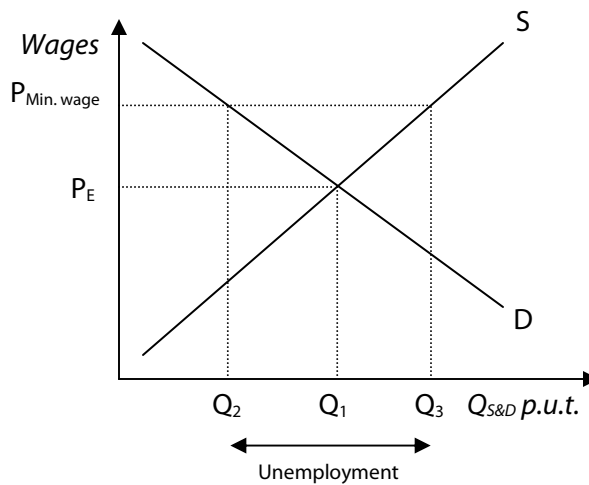
Capital:

- Decrease taxes to increase profits, so encourage more entrepreneurship and investment.
- Encourage lending to private firms for investment.
- Remove tariffs to increase efficiency.

- Encourage small firms to enter the market to encourage competition and keep prices low.
- Privatised state owned assets and deregulate industries letting the free market allocate scarce resources.

In the recent budget the government has chosen to implement the following supply side policies:

- Increased child care subsidies, this will hopefully lead to increased participation in the work force.
- Raised the minimum wage, arguably this may act as an incentive to enter the workforce which will lead to increased participation. However, some of those who are unemployed may be willing to work for less than the minimum wage and so the minimum wage creates an excess supply of labour of $Q_3 - Q_2$, which is unemployment.

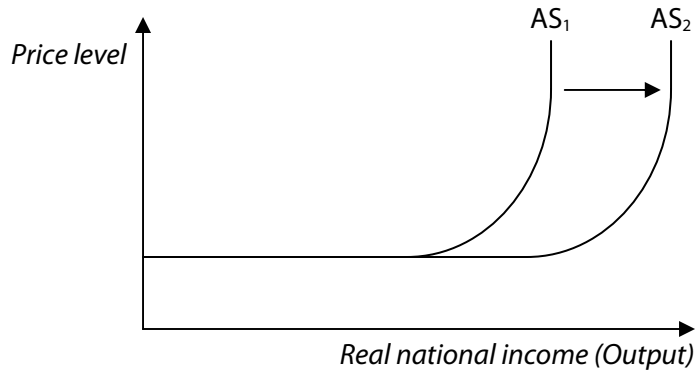


- More spending on research, through a 10 year framework to boost research and development within the UK. Increased investment improves the quantity and quality of resources. Increased research and development into high value output will help resolve the balance of payments situation as when eastern European countries join the EU the UK will have further cheap competition from abroad.
- Increase housing, in the short run this will increase the demand for builders and so increase aggregate demand a small amount but in the long run this policy is aimed at increasing the geographical mobility of labour within the economy.
- Changes in taxes and duties may change business practises.
- Improving the UK's infrastructure should make the UK more competitive as fewer hours will be wasted travelling and delivery will become cheaper.
- Reforms to regulations on businesses will reduce costs to businesses and free up scarce resources used in regulation for another application.
- More British films being made through subsidies. This may help exports.
- Reforms to local growth authorities giving them more power to achieve their own goals.

How effective is government funding at increasing growth?

Government funding has a large effect if...

- More jobs are created in the local area.
- Local multiplier effect causes this to increase and so cause a shift outwards in aggregate supply from AS_1 to AS_2 .



- Lower businesses costs as...
 - More use of labour.
 - More investment.
 - More training.

Government funding has less of an effect if...

- Profits are repatriated abroad rather than reinvested locally if the investment is FDI (foreign direct investment).
- Requires more than money. Local councils need to agree with the expansion. If local planning permission for example is not granted the move may be unpopular.
- May be limited government funding split between many regions. A fraction of the money allocated may reduce incentives to companies.
- For those who want to trade with Europe a base anywhere other than the south east is not an option they would consider. Europe accounts for ~50% of the UK's trade so companies want to situate themselves near the channel tunnel.