3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

The goals of the policy include:

- Promote long-term growth by increasing the productive capacity of the economy
- Improve competition and efficiency
- Increase labour market flexibility
- Increase incentives of firms to invest
- Reduce inflation to improve competitiveness with foreign rivals.

Supply-side Policies

Supply-side policies focus on the production and supply-side of the economy.

It is undertaken by the government and it aims to increase the level of **aggregate supply** in a country and to promote **long-run economic growth**.

It does not attempt to stabilise the economy by reducing the severity of the **business cycle**.

3.5 - 3.7 Demand-side and Supply-side Policies

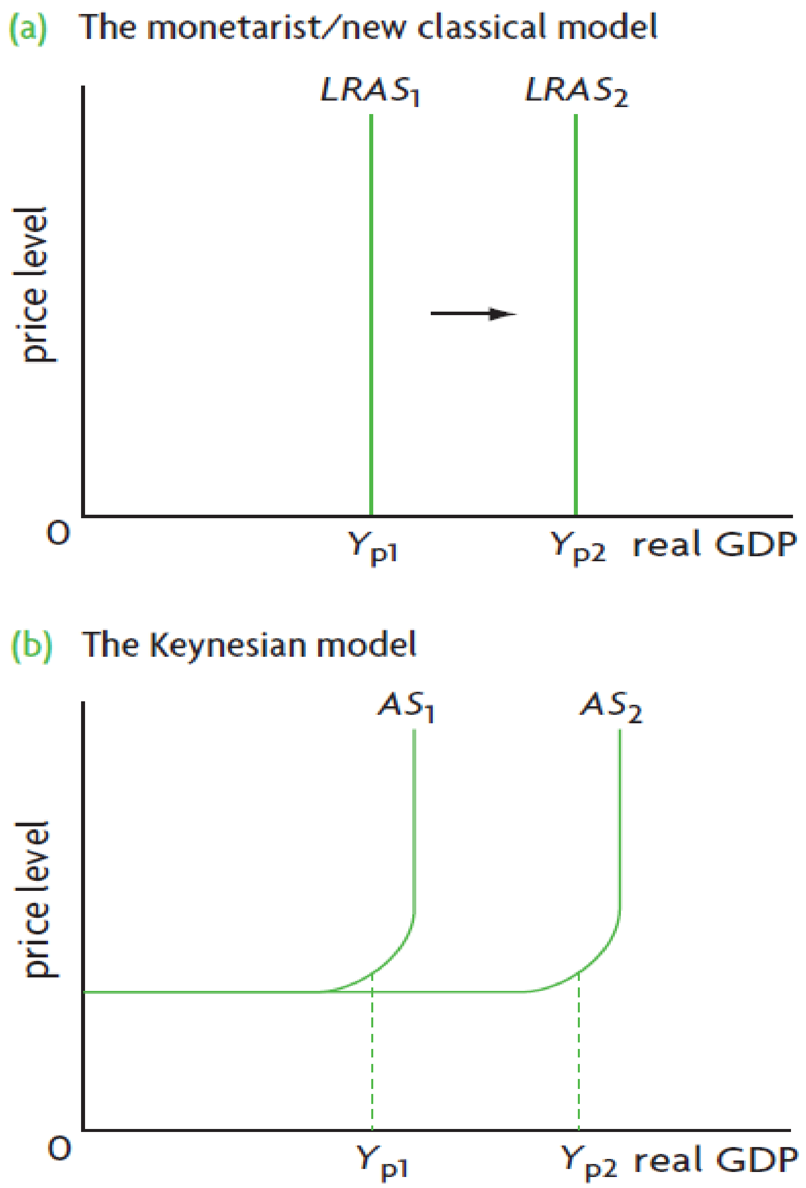
Supply-side Policies

Supply-side policies focus on the production and supply-side of the economy. It focuses on

- Increasing the quantity and quality of factors of production
- The institutional changes intended to improve the productive capacity of the economy

The two major categories are:

Interventionist	Market-Based

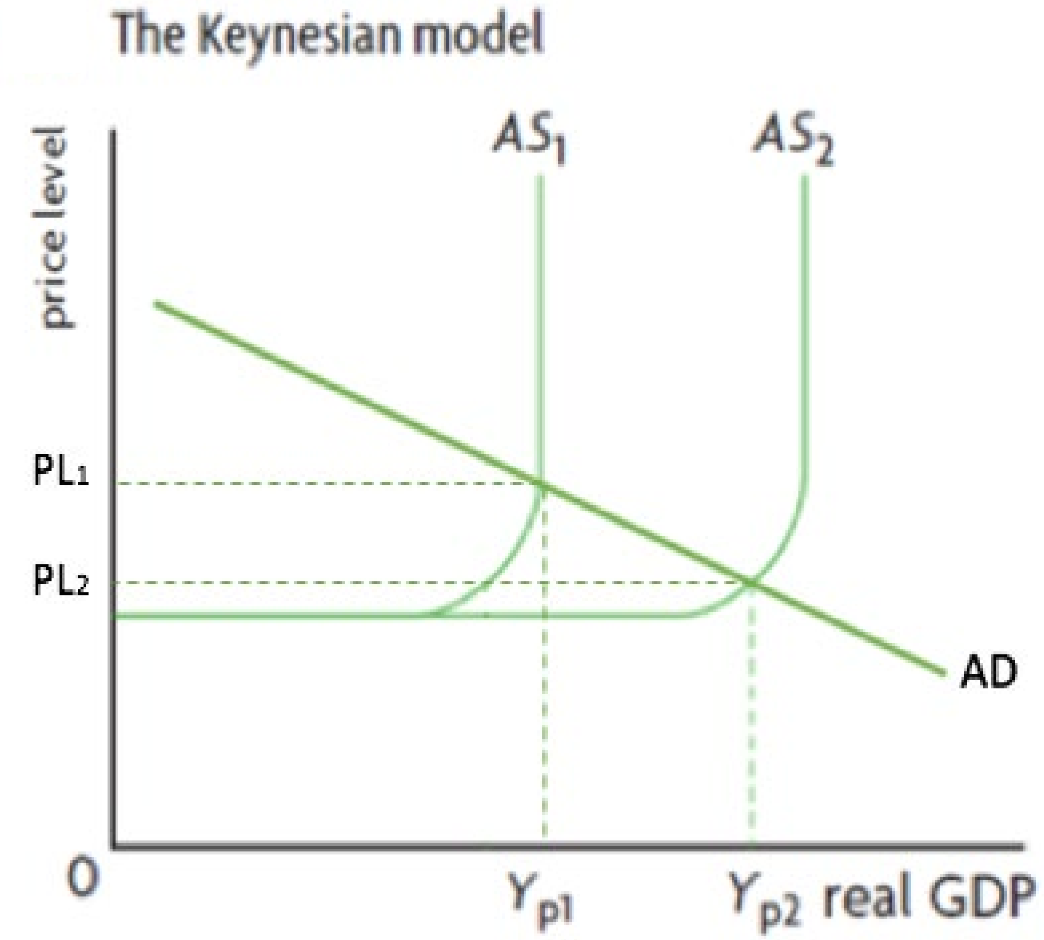


Supply-side Policies

Supply-side policies focus on the production and supply-side of the economy.

Impact on **macroeconomic objectives**:

- Price levels decrease
- Real GDP increase
- Unemployment decreases
- Income distribution - uncertain



3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

Interventionist Policies

These policies rely on government intervention to achieve growth in potential output.

Market-Based Policies

These policies emphasise the importance of well-functioning competitive markets in achieving growth in potential output.

3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

Interventionist Policies

These policies rely on government intervention to achieve growth in potential output.

Market-Based Policies

These policies emphasise the importance of well-functioning competitive markets in achieving growth in potential output.

Policies can include:

- Investments in human capital
- Investments in new technology
- Investments in physical capital
- Lower business and income taxes
- Elimination of minimum wage
- Reducing labour union power
- Reducing unemployment benefits
- Deregulation
- Trade liberalisation

Review the list of policies…
And categorise them into either interventionist or market-based.

3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

Interventionist Policies

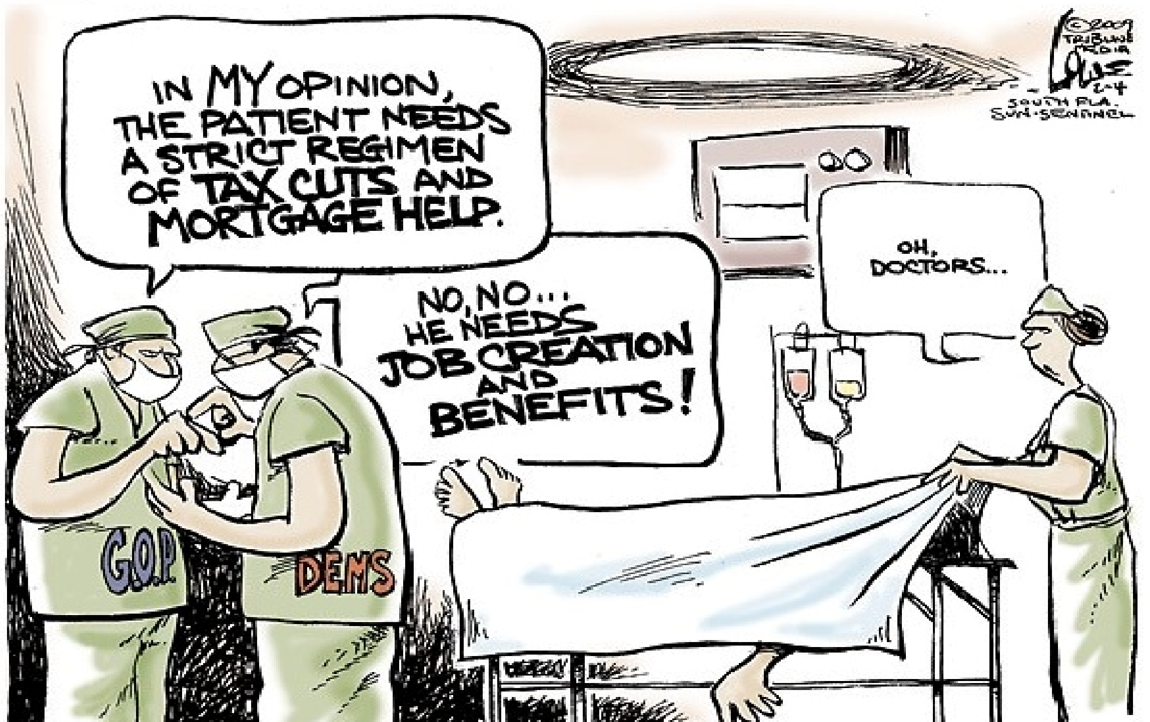
These policies rely on government intervention to achieve growth in potential output.

Market-Based Policies

These policies emphasise the importance of well-functioning competitive markets in achieving growth in potential output.

Some of the supply-side policies also have demand-side effects.

Key difference is demand-side policies focus on the **actual short-run output**.



Market-Based Policies

These policies focus on 'freeing up' markets by promoting competition and efficiency.

They can be broadly classified into:

- Encouraging competition
- Labour market reform
- Incentive-related policies

Market-Based Policies

Encouraging competition

Privatisation involves a transfer of ownership of a firm from the public to the private sector.

Based on the argument that government enterprises are often

- Inefficient
- Have high administrative costs
- Have unproductive workers

Examples include:

MTR 港鐵

ROLLS ROYCE

JAL

Royal Mail

Liverpool John Lennon Airport

Faster. Easier. Friendlier.

Market-Based Policies

Encouraging competition

Deregulation involves the elimination or reduction of government regulation of private sector activities.

The goals of **regulation** are often to reduce the impact of **negative externalities** arising from the production or consumption of certain goods.

Market-Based Policies

Encouraging competition

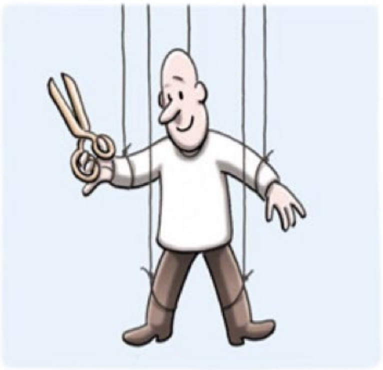
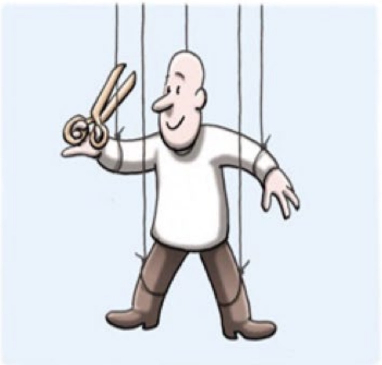
Deregulation involves the elimination or reduction of government regulation of private sector activities.

The goals of **regulation** are often to reduce the impact of **negative externalities** arising from the production or consumption of certain goods.

The cost of complying to regulation leads to:

- Higher average costs for firms
- Lower levels of **aggregate supply**

Removing or loosening regulations in certain industries will lead to lower costs and greater output – increasing **aggregate supply**.


3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Encouraging competition

Deregulation involves the elimination or reduction of government regulation of private sector activities.

Example: The United States Environmental Protection Agency (EPA) is often accused of imposing harmful regulations on producers of good ranging from automobiles to agriculture products.

Benefits of environmental regulations:

Reduced emissions of harmful toxins that affect human health and the environment.

Cost of environmental regulations:

Impact on employment and price level. Reducing them will lead to more output and lower prices in the regulated industries.

EPA United States Environmental Protection Agency

3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Encouraging competition

Free trade refers to the exchange of goods and services between nations without protectionism by the government.

Protectionism is the use of **tariffs, quotas** or other measures aimed at making domestic producers more competitive by limiting the quantity of imports into the nation.

3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Encouraging competition

Free trade refers to the exchange of goods and services between nations without protectionism by the government.

Protectionism is the use of **tariffs, quotas** or other measures aimed at making domestic producers more competitive by limiting the quantity of imports into the nation.

Supply-side effects:

- Reducing **protectionism** allows producers in a nation to import raw materials and other resources more cheaply.
- Domestic firms become more efficient
- Increase in the nation's **aggregate supply** and contribute to **long-run economic growth**.

Market-Based Policies

Labour Market Reforms

Labour is the most important (and the most costly) resource for most producers.

Reforms of the labour market helps to:

- Bring down cost of labour
- Increase nation's aggregate supply
- Lead to growth in national output

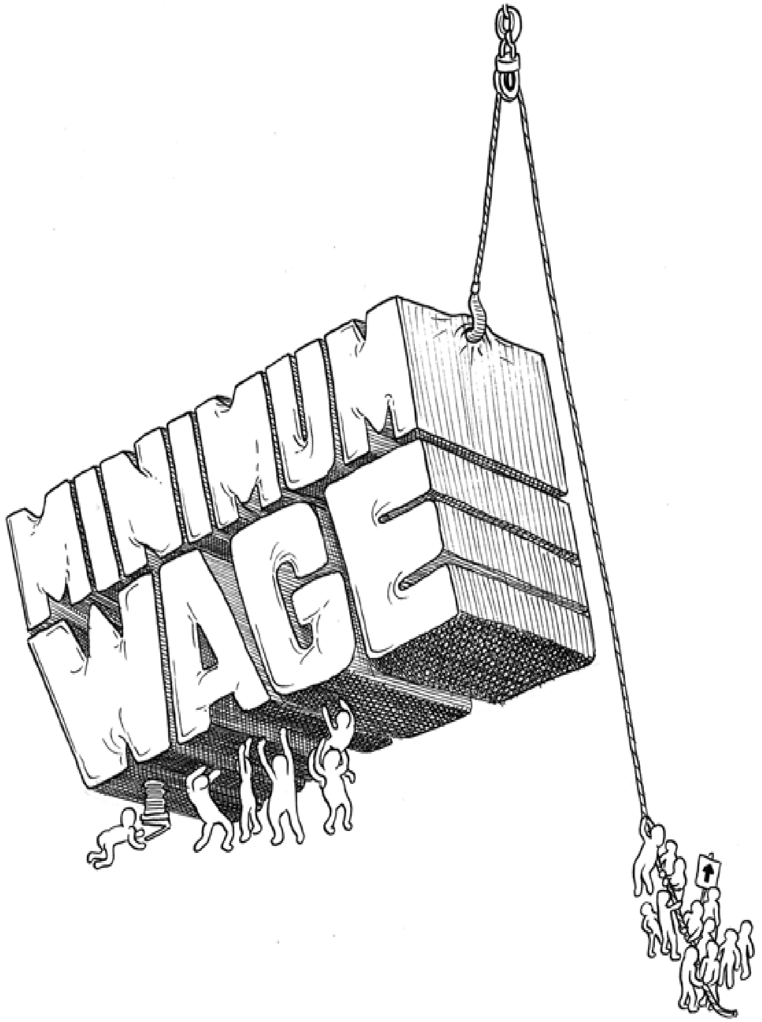
Market-Based Policies

Labour Market Reforms

Reducing or eliminating the minimum wage

The **minimum wage** is a price floor in the labour market set above the free market equilibrium wage rate.

Reducing or eliminating minimum wages may lead firms to hire more workers. This will help firms to produce more output at a lower per unit cost.



3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Labour Market Reforms

Reducing labour union power

Labour unions are organisations of workers in particular industries that negotiate with employers for better worker benefits such as

- Higher wages
- More paid vacation
- Better healthcare

3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Labour Market Reforms

Reducing labour union power

Labour unions are organisations of workers in particular industries that negotiate with employers for better worker benefits such as

Find examples of trade unions

HK Social Workers' General Union
Aviation Industry Employees Union

3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Labour Market Reforms

Reducing labour union power

Labour unions are organisations of workers in particular industries that negotiate with employers for better worker benefits such as

- Higher wages
- More paid vacation
- Better healthcare

These benefits add to firms' cost of production and keep **aggregate supply** lower than it might be otherwise.

Reducing the power of unions will lower labour costs for producers and shift **aggregate supply** outwards.

Market-Based Policies

Labour Market Reforms

Reducing unemployment benefits

Unemployment benefits are the money payments individuals received during the period of time when they are out of work and seeking a new job.

Reducing these benefits would create an incentive for unemployed workers to accept a new job more quickly and at a lower wage rate than they otherwise might accept.

Firms will find more workers willing to work for lower wages.

3.5 - 3.7 Demand-side and Supply-side Policies

Market-Based Policies

Labour Market Reforms

Reducing job security

Many countries have laws protecting workers against being fired.

Reducing workers' job security will make it easier and less costly to fire workers which has an effect on increasing employment.

End of Heisei Era and lifetime employment

Times are changing for Japanese white-collar workers as firms begin to shift away from lifetime employment. | BLOOMBERG

BY YUMIKO MURAKAMI

SHARE May 2, 2019

The lifetime employment system is no longer sustainable, Hiroaki Nakanishi, chairman of Keidanren (the Japan Business Federation) told a news conference last month when the top business lobby's new recruiting guidelines for college graduates were announced. Nakanishi's comment has made waves throughout the Japanese business community, raising anxiety among white-collar workers, otherwise known as salarymen. The truth is the lifetime employment system was not sustainable for much of the just-ended Heisei Era.

Market-Based Policies

Incentive-Related

Reduction in **taxes** to increase incentives to work and investment can positively impact aggregate supply as

- Business taxes are a cost of production
- Income taxes serve as a disincentive to work

Interventionist Policies

Investments in Human and Physical Capital

Not all investment needed for economic growth will be undertaken by the private sector.

- **Education (as a merit good)**

  A better educated workforce is more productive, and provides firms with higher skilled workers to produce more and better output.

  A better educated workforce will earn higher incomes and thus pay more in taxes.

  Spending in **healthcare** would provide a similar result.

Interventionist Policies

Investments in Human and Physical Capital

Not all investment needed for economic growth will be undertaken by the private sector.

- **Infrastructure (as a public good)**

  Better infrastructure reduces the costs for private businesses and allows them to operate more efficiently.

  Goods and services can be sold at a lower cost.

  A modern, efficient infrastructure allows **aggregate supply** to increase over time.

Interventionist Policies

Investments in Human and Physical Capital

Not all investment needed for economic growth will be undertaken by the private sector.

- **Spending on Research and Development (R&D)**

  Research in improving production techniques, product design and quality will help to

  - Improve productivity
  - Encourage better utilization of resources.

Interventionist Policies

Industrial Policies

Industrial policies are government policies designed to support the growth of the industrial sector of an economy.

They include:

- Support for small and medium-sized enterprises of firms
- Support for infant industries

In the form of tax breaks, grants, low-interest loans and business guidance

3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

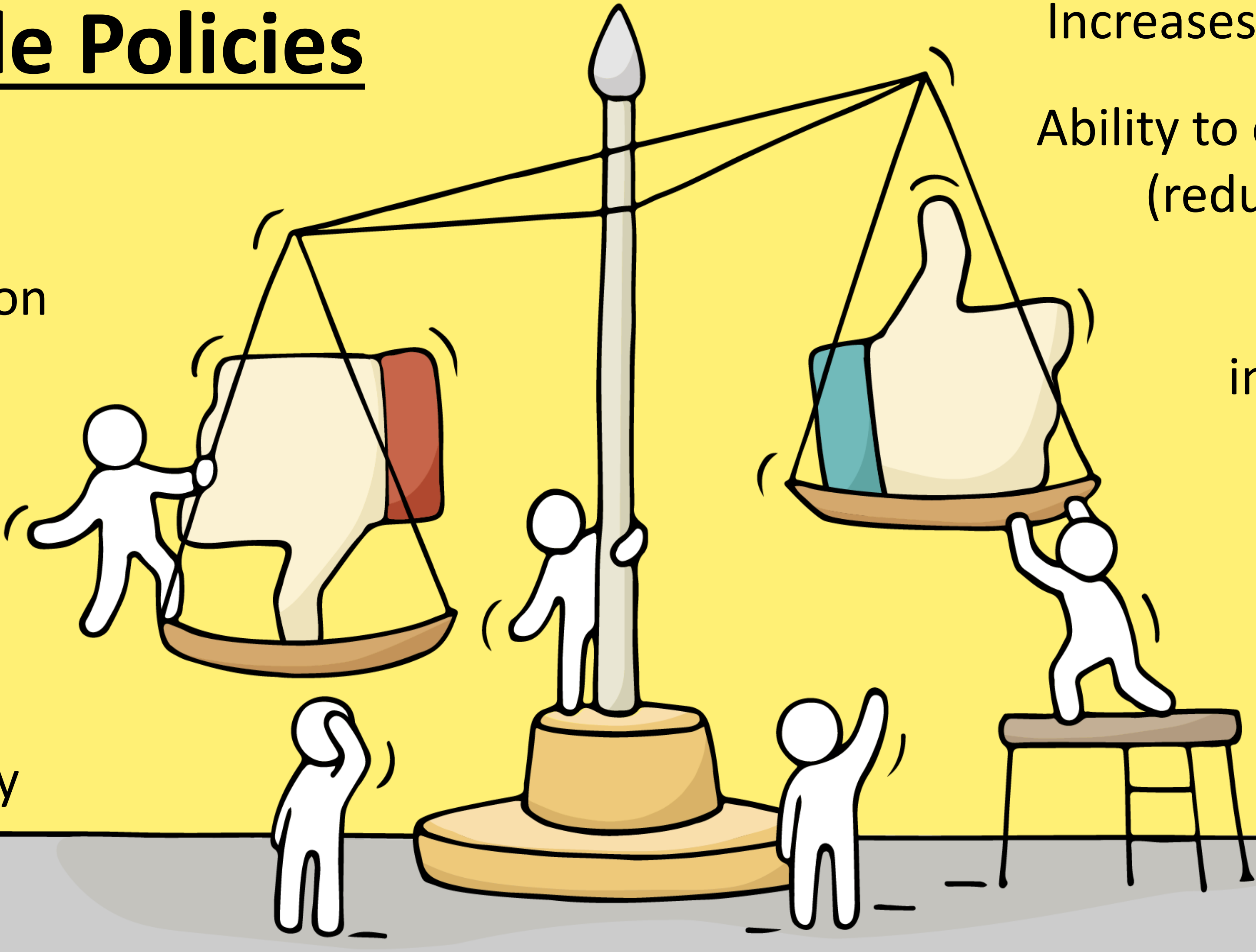
Time lags

Negative effects on the government budget and unemployment

Environmental concerns

Income inequality

Political realities



Increases in potential output

Ability to create employment (reduce unemployment)

Ability to reduce inflationary pressure

Improves resource allocation

Direct support of important sectors

Supply-side Policies

Undesirable Consequences

Increased inequality

Supply-side labour market reforms often result in lower incomes for the working class as

- Unemployment benefits falls
- Labour union power reduced
- Minimum wages eliminated or cut

Supply-side tax reforms may also **redistribute** the total burden of taxes in a nation away from the higher income earners and more onto the middle and lower income earners.

3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

Undesirable Consequences

Political realities

Increasing spending on education and infrastructure is often times politically difficult as payoff from such investments are not seen for years or even decades – long after the members of the current government are out of office.

Environmental concerns

Decreased regulation of the private sector may lead firms to find new ways to externalize costs on third parties – meaning increased environmental damage

3.5 - 3.7 Demand-side and Supply-side Policies

Supply-side Policies

Undesirable Consequences

Resource misallocation

Government interference may result in less efficient outcomes because of…

- Political pressures
- Lack of necessary information
- Incorrect choice of industries to support

Effectiveness of market-based policy

Increases in disposable income due to tax cuts may result in the decision to work less.

Investments and savings may not be affected as intended as firms choose to save.

Lower labour productivity

Minimum wage has been proven to encourage workers to be more productive.

Overlaps between Demand-side and Supply-side Policies

Some **demand-side policies** have not only demand-side but also supply-side effects and can affect long-term economic growth by increasing **Yp**.

An increase in AD in the short-term can influence an increase in **Yp** through…

- New capital formation
- Increased R&D/technological advancement
- Improvement in the quality of the labour force