2.17 Supply-Side Policies: Market-Based Approaches: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 25 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions in full sentences where required. The final 25-mark question requires a developed evaluative response. Total time guidance 25 minutes.

1 Define the aim of supply-side policy in the context of raising an economy's long-run productive potential and LRAS, as used in UK macroeconomic debate.

(Total for Question 1 is 2 marks)

2 Explain how a cut in marginal income tax rates is intended to increase labour supply and thereby shift LRAS to the right in the UK economy.

(Total for Question 2 is 3 marks)

3 Explain how deregulation of product markets is expected to improve efficiency and increase LRAS in a UK market-based supply-side framework.

(Total for Question 3 is 3 marks)

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4 Explain how reducing the generosity of out-of-work benefits is intended to affect labour market participation and LRAS in a market-based policy package for the UK.

(Total for Question 4 is 3 marks)

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5 Diagram task: In the context of UK market-based supply-side policy, draw an AD/AS diagram showing the effect of product market deregulation on long-run aggregate supply. Label axes, show LRAS before and after the reform, and briefly indicate any likely short-run effect on price level and output.

(Total for Question 5 is 4 marks)

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Mark scheme · 2.17 Supply-Side Policies: Market-Based Approaches: Test Pack

Question 1

statement that supply-side policy aims to increase the economy's productive capacity or potential output	**B1**
links this to a rightward shift in long-run aggregate supply (LRAS), increasing potential real GDP	**B1**

Answer: Supply-side policy aims to raise the economy's productive capacity, increasing potential output and shifting LRAS to the right.

Question 2

cutting marginal income tax raises the after-tax reward to work	**M1**
this increases the incentive to work more hours, enter employment or seek higher-paid jobs, increasing labour supply and productive input	**A1**
therefore potential output rises and LRAS shifts rightwards, other things equal	**A1**

Answer: Lower marginal income tax increases the after-tax reward to work, encouraging higher participation and hours worked, raising labour inputs and shifting LRAS right.

Question 3

deregulation reduces barriers to entry and removal of restrictive rules for firms	**M1**
this increases competition, forces firms to cut costs and innovate, and allocates resources more efficiently	**A1**
improved efficiency and innovation raise productive capacity and shift LRAS to the right	**A1**

Answer: Deregulation lowers entry barriers and increases competition, encouraging cost reduction and innovation, improving efficiency and shifting LRAS right.

Question 4

less generous benefits lower the reservation wage and the incentive to remain out of work	**M1**
this encourages job search and higher labour force participation, increasing the supply of labour available to firms	**A1**
higher participation increases potential output and shifts LRAS to the right	**A1**

Answer: Cutting benefit generosity lowers the reservation wage and incentivises job search, increasing labour participation and potential output, shifting LRAS right.

Question 5

correctly labelled axes: Price level (vertical) and Real GDP/Output (horizontal)	**B1**
initial LRAS drawn vertical at potential output	**B1**
new LRAS drawn vertical to the right of the original LRAS, indicating increased productive capacity	**B1**
brief statement or diagrammatic indication that short-run output may rise somewhat and price level effect depends on AD position, but long-run potential output is higher (award for valid link to price/output)	**B1**

Answer: Axes labelled Price level and Real GDP; LRAS1 vertical at potential output; LRAS2 vertical to the right; short-run output and price effects noted.

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