

2023 H2 A Level Paper 2 Question 6

The use of expansionary demand-side policies designed to achieve economic growth or to lower unemployment may lead to undesirable consequences.

- (a) Explain why expansionary fiscal policy designed to achieve economic growth or lower unemployment may lead to undesirable consequences. [10]
- (b) Discuss whether expansionary supply-side policies would be effective in achieving the macroeconomic policy aims for an economy. [15]

Part (a) (Question Analysis)

Approach	Command Word	Explain why
	Start point	Expansionary fiscal policy → higher growth + lower u/e
	End Point	Undesirable consequences
Content and Context	Content	<ul style="list-style-type: none">• Expansionary fiscal policy for growth / lower u/e• And its consequences
	Context	Generic

Suggested Response

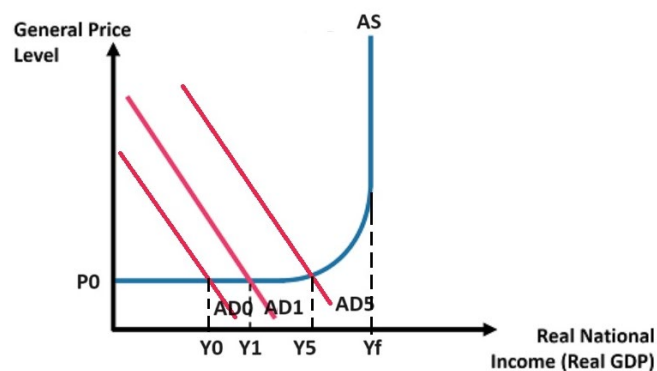
Introduction

- Economic growth refers to the rate at which an economy's real national income/output increases over a period of time.
- Lower unemployment refers to a fall in the proportion of the labor force that is unemployed.

Requirement (1) – Undesirable consequence of demand-pull inflation.

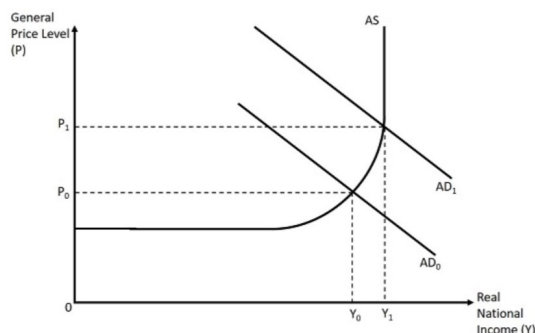
- Expansionary fiscal policy refers to when the government increases government expenditure (G) and decreases taxes (personal income tax and corporate income tax) to increase aggregate demand (AD) via the components of G, consumption (C) and investment (I) respectively.
- AD refers to the total spending on goods & services produced in the economy at each general price level by the four sectors (h/hlds, firms, govt and foreigners).
- Assuming the economy is initially operating below full employment output level, along the horizontal range of the AS curve.
- With the rise in AD from AD₀ to AD₁ (Figure 1), total spending exceeds total output produced → unplanned fall in stocks / inventories. Firms step up production of output by hiring more factors of production including labor, leading to the increase in real NY from Y₀ to Y₁ in the first round of the multiplier process → triggers the multiplier process where the increase in induced-consumption further increases AD from AD₂ to AD₅ for a few rounds. The multiplier process stops when the rise in real NY is insignificant to create increases in induced consumption. The real NY increased by multiplied from Y₀ to Y₁ to Y₅ → Actual growth is achieved.

Figure 1: Economic (actual) growth



- However, if the economy was on the intermediate or vertical range of the AS, that is operating near or at full employment \rightarrow resources become increasingly scarce and firms have to compete for them, pulling up prices and costs \rightarrow GPL increases from P_0 to P_1 , leading to demand-pull inflation (Figure 2).

Figure 2: Demand-pull inflation



Requirement (2) – Undesirable consequence of crowding out effect

- Expansionary fiscal policy can lead to the undesirable consequence of crowding out. Crowding out occurs when governments may borrow to fund their spending. Crowding out is the decrease in private expenditures (C and I) that occurs as a consequence of increasing the government budget deficit. Then the government needs to borrow in order to pay for its overspending. However, this increases the price of money / cost of borrowing / interest rate. As interest rate rises, consumption and investment spending fall, leading to crowding out. This effect renders expansionary fiscal policy less effective than intended because the increase in G is offset by the decreases in C and I, so overall effect on the increases in AD is muted.
- (Note: How non-sustainable growth might also be a possible point.)

Conclusion

The two undesirable consequences are demand-pull inflation and crowding out effect.

Mark Scheme

Band	Knowledge, Understanding, Application, Analysis	Marks
L3	For an answer that shows well-developed explanation of the concepts of demand-pull inflation and crowding out.	8-10
L2	For an answer that shows under-developed analysis of the undesirable consequences <ul style="list-style-type: none">lacks details in analytical explanation (i.e., limited use of AD/AS analysis, gaps in demand-pull inflation analysis or gaps in diagrammatic analysis) Or, for an answer that provides one relevant undesirable consequence	5-7
L1	For an answer that shows limited knowledge of undesirable consequences. <ul style="list-style-type: none">with listing of points, unexplained statements, or descriptive responsemajor conceptual errors	1-4

- (b) Discuss whether expansionary supply-side policies would be effective in achieving the macroeconomic policy aims for an economy. [15]

Part (b) (Question Analysis)

Approach	Command Word	Discuss whether – balanced answer with evaluation
	Start point	Supply-side policies
	End Point	Macroeconomic policy aims
Content and Context	Content	<ul style="list-style-type: none">Economic growth (Actual, Potential, Sustainable)Unemployment
	Context	An economy

Suggested Response

Introduction

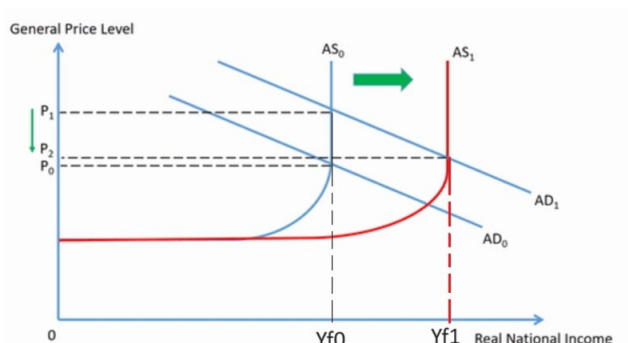
- The selected macroeconomic policy aims for an economy in this discussion are inclusive and sustainable growth and low unemployment
- (other macroeconomic policy aims ie low inflation, healthy BOT are acceptable)

Requirement (1) – How expansionary supply-side policies works to achieve inclusive / Sustainable growth + Limitations

- Inclusive growth refers to the growth that is broad-based across economic sectors and creates productive employment opportunities for the majority of the country's population. To achieve inclusive growth = sustained growth + equity.
- Or Sustainable growth = a rate of growth that can be maintained without creating other significant economic problems (such as resource depletion and environmental problems), particularly for future generations. To sustainable growth = sustained growth + environment.
- A type of expansionary supply-side policies promote long-term growth by raising the quantity and quality of resources (eg investments in education, capital and technology) e.g. eg Automation Support Package e.g. self-serving kiosks at restaurants, that help firms to automate their production processes

- → increase in the productivity of capital and labour resources ie more output produced per input per time → increase the production capacity of the economy, increasing long-run aggregate supply (LRAS) and potential growth.
- An expansionary supply-side policies require some government expenditure in the investments → so it can have the secondary effect of increasing the G component of AD → actual growth.
- With both actual growth and potential growth, sustained growth is achieved ie growth can be sustained without inflationary pressures (Figure 3)

Figure 3: Sustained growth



- Expansionary supply-side policies can achieve sustainable growth via Innovation / promotion of green technology eg solar energy that help reduce carbon emissions/ global warming. Rising productivity also means getting more out of existing resources so fewer resources are wasted.
- **Limitations:**
 - Policy conflict / trade- off: Improving productivity through automation to achieve potential growth may result in structural unemployment if low- skilled workers don't have relevant skills so unable to find employment in high- skilled jobs.

Intermediate Evaluation (1)

- The **extent** of the danger of structural unemployed is that it could lead to income inequality as the income gap widens between the unemployed or even low-skilled workers and high-skilled workers, there is the risk of the economic growth which is non-inclusive.

Requirement (2) – How expansionary supply-side policies works to achieve low unemployment + Limitation

- Another type of supply-side policies enhance factor mobility by promoting retraining, job matching and various measures to enable both factor and product markets to operate more efficiently.
- Improve labour mobility → Retrain workers can make them more employable as they are now equip with the skills relevant to the new jobs / sectors → reduces the mismatch between jobs and skills and thus reduces structural unemployment.
- Encouraging skills upgrading can help low-skilled workers more employable with better jobs and higher pay → narrowing income gap between high-skilled and low-skilled workers → reducing income inequality → can also achieve inclusive growth.

- **Limitations:**

- Success of supply-side policies depends on the receptiveness of firms and workers despite government support. Workers may not want to undergo retraining or skills upgrading. Firm/employer support is also a big hurdle.
- Financial support eg Singapore's SkillsFuture credit of \$500 may not be enough. It is also costly. Furthermore, with government efforts to invest in human capital incurs opportunity costs in terms of spending elsewhere forgone.

Intermediate Evaluation (2)

- The **extent** of the effectiveness of the policy will depend on the receptiveness of firms and workers. The government needs to convince and create the buy-ins that increasing labour productivity will benefit for employers and workers. Individual workers will then be motivated to embark on the skills upgrading with the adequate support from their firms e.g. flexible working hours during courses.
- **The extent** of the feasibility of the policy will depend on the state of the government budget to sustain the workers' training.

Summative Evaluation

- **Stand:** In conclusion, expansionary supply-side policies can achieve the macroeconomic policy aims of inclusive and sustained growth and low unemployment by increasing the economy's LRAS primarily and increasing factor mobility in the long run.
- **Justification:** Expansionary supply-side policies are effective especially in the context of globalisation and technological advancement. Globalisation and technological disruption are some of the root causes of higher structural unemployment and widening income inequality. Moreover, many developed countries have been experiencing stagnant LRAS as productivity suffers, hence supply-side policies are appropriate to achieve sustained growth which is prerequisite for inclusive / sustainable growth.
- **Recommendation:** However, in the short run, expansionary demand-management policies are more effective because the policies can respond quickly to a fall in the aggregate demand as evident in the Covid pandemic recession.

Mark Scheme

Band	Knowledge, Understanding, Application, Analysis	Marks
L3	For an answer that shows well-developed and well-balanced explanation of how expansionary supply-side policies achieve the two policy aims <ul style="list-style-type: none"> • well-supported with diagrammatic analysis (AD/AS diagram) 	8-10
L2	For an answer that shows under-developed explanation (i.e. limited effective use of relevant economic analysis or gaps in diagrammatic analysis); Or one-sided explanation of one potential supply-side policy, and an irrelevant alternative policy such as expansionary fiscal policy, exchange rate policy or use of FTAs.	5-7
L1	For an answer that shows limited knowledge that lacks breadth or depth <ul style="list-style-type: none"> • with listing of points, unexplained statements, or descriptive response • major conceptual errors ie confuse demand-side and supply-side policies • Smattering of points 	1-4

Band	Evaluation	Marks
E3	For an answer that arrives at a well-explained evaluative judgement about the extent of the effectiveness of supply-side policies in achieving macroeconomic policy aims ie appropriate evaluative judgements about the likely effectiveness of supply-side policies in achieving the macroeconomic policy aims, culminating in a summative conclusion.	5
E2	For an answer that make some attempts at a judgement about the effectiveness of supply-side policies in achieving macroeconomic policy aims ie a single evaluative judgement that was well-explained or made statements rather than explain the underlying reasons for their judgements.	3-4
E1	For an unsupported statement about the extent of the effectiveness of supply-side policies in achieving macroeconomic policy aims or summative conclusion was either missing or repeated a statement of the judgements already made.	1-2