PEARSON EDEXCEL INTERNATIONAL AS / A LEVEL

ECONOMICS

TEACHER RESOURCE PACK 1

PAPER 2, SECTION D, 20 MARK QUESTION

Context material: Thinking like an economist – 'South Africa: A walk on the "supply side"' (Student Book, p.303)

With reference to the context material, evaluate the potential effects of supply policies on economic growth in South Africa.

[20 marks]

Key to assessment objectives: Knowledge (K), Application (A), Analysis (AN), Evaluation (E)

South Africa, the article states, was in recession in June 2017 (A). A recession is defined as two consecutive quarters of negative growth of GDP (K). Unemployment in South Africa (those without work who are seeking, willing and able to work) is given as 27 per cent (A).

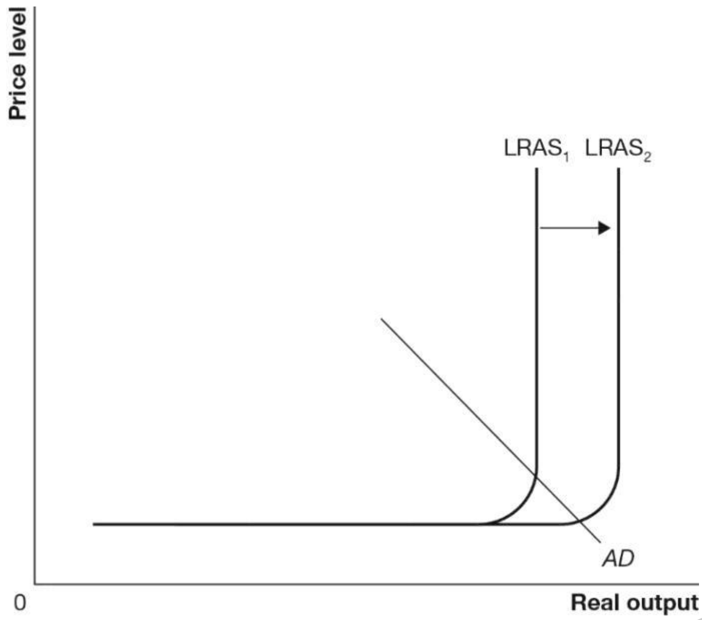
Supply-side policies are used to expand the productive potential of an economy, which will effectively cause the production possibility frontier (PPF) and LRAS to shift outwards ($LRAS_1$ to $LRAS_2$). These types of policy may increase the trend rate of growth of an economy as well. Supply-side limitations may limit growth in an economy (K) – the OECD suggests that this is the case in South Africa (A).

Supply-side policies may take the form of enabling the free market to work better by removing or decreasing some of the constraints, such as taxes and regulations, as well as correcting market failure by increasing education, making improvements to infrastructure and subsidising new industry or technology (or assisting with research and development) (K).

> These opening paragraphs set the scene well. They identify the problem (in context) to be analysed and define the major key terms.

Possible supply-side policies, which are identified by the OECD include:

1. **Increased education of working-age people.** The OECD report shows that South Africa has a problem of skills shortages and the wrong sorts of skills ('mismatches') (A). Some people have a lack of education, having left school too early. This means that they lack occupational mobility and are only able to do a narrow range of unskilled tasks. By providing them with a better education, perhaps through apprenticeships, they will have more opportunities due to a greater range of jobs open to them and are more likely to find employment. As a result, greater education will enable them to become more productive in the economy. As this part of the labour force becomes more skilled, demand for this labour would be expected to increase, thus reducing unemployment and expanding the economy (productive capacity – LRAS and through AD – increased consumption due to better wages) (AN).



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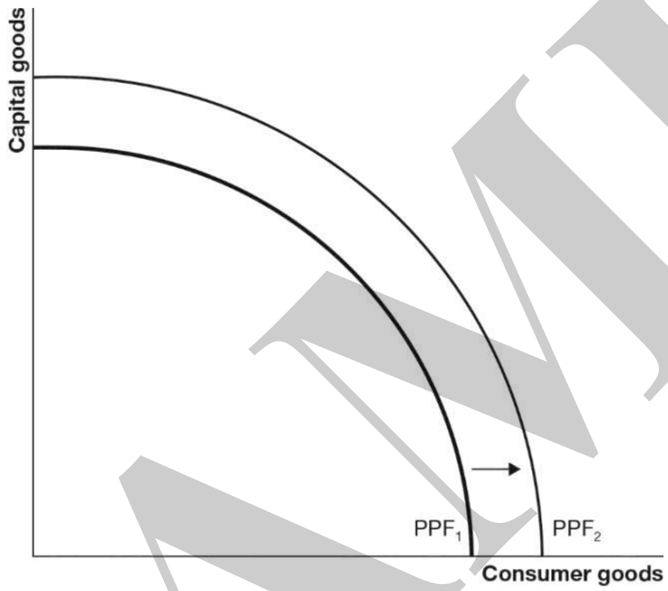

Furthermore, with increased education and skill level of the workforce, it is possible that the quality and reputation of South Africa's (A) produce will increase, adding further to the country's international competitiveness. This would potentially increase both consumption (part of AD), as consumers switch to locally produced products instead of imports, and exports, due to increased quality and decreased prices. This will have the effect of increasing AD, moving it to the right. This results in an increased output of the economy and real GDP (AN).

2. **Improved infrastructure, such as transport and communication networks.** By improving transport infrastructure, such as roads and railways, the costs of moving goods would be expected to decline, which will decrease the cost of production (A). A decrease in costs can mean a reduction in prices and therefore improve the competitiveness of South Africa's production both domestically (local markets instead of

imported goods) and internationally, for export markets, assuming that all else stays the same (AN).

Furthermore, improved transport infrastructure (A) would benefit geographic labour mobility, potentially making it easier for workers to be matched with the right sort of job. It means that people would not need to move house or location to be able to work, which they may be unwilling to do due the cost and inconvenience of moving away from family and friends (AN). This would potentially reduce unemployment (A).

Improved communication networks, such as mobile phone and internet (A), could further have an impact on labour immobility, making it possible to work remotely and to identify work opportunities, thereby (AN) decreasing work 'mismatches' (A).

3. **The OECD also suggest 'lowering barriers to entrepreneurship and improving the business environment' (A).** This would involve supply side policies that reduce regulation and bureaucracy, making it easier to start new businesses and reducing costs for on-going businesses. Regulation, relating to the registration and start-up of a new business could be changed, which would reduce the effort and cost and may encourage more people to do this. Furthermore, reductions in business taxes, such as those on business premises or on profits, may provide further encouragement (AN).

4. **The OECD mention high barriers to entrepreneurship and suggest that reforms are needed to reduce 'red tape' for firms (A).** Employment law and trade union involvement may also make it difficult to run a business due to additional costs in making sure that it meets the legal requirements. Therefore, a reduction of laws (which could include a lower minimum wage or less protection for workers if they are made redundant) could increase the number of businesses and also increase employment (AN). This would decrease unemployment, which is very high (A), and further increase AD through additional consumption (people with jobs will presumably have increased amounts of money to spend, than if they are unemployed or on benefits.) (AN)

> There is a very clear link of the four points above to the solutions suggested by the OECD in the context material. These have been analysed well.

However, deregulation of the labour market, which gives less power to the worker (through restraints on trade union power), relaxation of redundancy laws or decreasing the national minimum wage will result in less job security and poorer working conditions for workers. This may mean that employed workers find that they are paid less or are displaced by cheaper workers. This could cause a decrease in productivity and a decrease in product quality, as workers have fewer incentives to work. This would decrease consumption as workers' marginal propensity to save (MPS) would be likely to increase due to a loss of consumer confidence. This would potentially reduce the consumption component of AD, causing a leftwards shift of the AD curve and a reduction in real national output. (E)

Furthermore, tax receipts may fall if workers are paid less, although this may be countered by a decrease in welfare payments. A fall in tax receipts, which means that the government has less money to spend, would have further

> The 'furthermore' point expands the previous point, increasing the strength of the argument here and moving these two paragraphs into Level 4.

downward pressure on AD as the government spending part of AD would fall as well. (E)

Government spending on education and infrastructure, whilst a supply side policy, relies on the government understanding how the supply side problems have occurred and how they should be resolved (K). This relies on the government having good knowledge and understanding of the economy, which may not be the case. The South African (A) government may not have accurate knowledge of where skills shortages occur and for what industries or employment sectors (particularly if these occur in private sectors workplaces). Furthermore, it may be difficult to either identify or provide the skills that are required for the economy to expand. Corruption and regulatory capture may make this problem worse, as government employees, departments and politicians attempt to divert money to projects that meet their requirements (e.g. popularity with voters, their own benefit). (E)

Additionally, supply side policies, such as improvements to education and infrastructure (A), take a long time to implement. Persuading people to go back to school may be difficult and therefore it may be that education reform can only take place from current and future students. Infrastructure is expensive and involves an opportunity cost for government, which must work out the best place to spend its money. Furthermore, supply side policies may not necessarily increase the output of the economy. Whilst the potential output of the economy may expand, the actual output may not, as that requires aggregate demand to increase. Instead, the output gap might increase. The supply side policies are unlikely to resolve the short-term issue of the current recession or the high unemployment level (A). These may be best tackled by demand-side policies. (E)

A very clear conclusion that does not repeat points previously made and makes a clear judgement that supply-side policies are unlikely to resolve the current issues that South Africa faces.

There is a lot in this essay and it is potentially longer than could be realistically written under timed conditions in an exam. It does show the depth of argument required to reach top marks and if two or three of the knowledge, application and analysis points (and relevant evaluation) were explained to this level, the highest level in the marking grid should be achievable.

