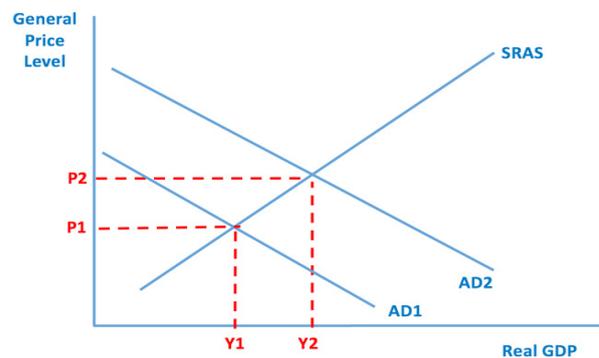


Evaluate policies that can be used to reduce the UK's level of unemployment at the same time as raising the UK's economic growth rate.

Unemployment is defined as the people who are willing and able to work at the going wage rate but are unable to find a job. There are several types of unemployment, including structural, cyclical, seasonal and frictional. Economic growth is an increase in the actual (SR) or potential (LR) output of the economy. This essay will discuss how fiscal, monetary and supply-side policies can be used to reduce the UK's level of unemployment whilst simultaneously raising its economic growth rate, arguing that a combination of policies will be most effective.

The first policy to be addressed will be fiscal policy, a demand-side policy, which uses government spending and taxation to influence aggregate demand (AD). In order to reduce unemployment, the government will use an expansionary fiscal policy, thereby lowering tax rates and increasing government spending. For example, if the government lowers income tax rates and increases spending on welfare benefits then disposable income for all consumers should increase. This will increase consumption in the economy and since consumption is a component of AD ($AD = C + I + G + (X - M)$), AD will rise, as shown in the diagram, from AD1 to AD2. As consumption rises, firms want to increase their output and so demand more labour as it is a derived demand. Therefore, unemployment falls, and the economy moves closer to full employment. The increase in employment raises output in the economy, from Y1 to Y2 in the diagram above, which causes an increase in the short-run economic growth rate. Therefore, an expansionary fiscal policy in the UK can reduce unemployment at the same time as raising the economic growth rate.



However, the success of this policy will depend on the confidence levels in the economy, which in turn are likely to be related to current economic performance. For example, the UK economy is currently experiencing relatively weak economic growth (although arguably better than expected following the Brexit vote in June 2016) and therefore consumer and business confidence might not be high. Thus, a fall in income tax rates may not trigger higher levels of consumption as consumers may wish to save their income as a precaution. Also, firms may not be confident that the higher consumption levels will last, especially as a result of the uncertainty associated with Brexit, and therefore may not hire extra workers; existing workers may simply become more productive, or work longer hours in order to meet the temporary increase in demand for goods and services, especially if they are employed on zero-hours contracts or in the so-called gig economy (e.g. Uber drivers and Deliveroo cyclists). In this case, unemployment would not fall and the positive impact on economic growth would be much smaller.

Secondly, expansionary monetary policy can also be used to reduce unemployment and raise the UK's economic growth rate. Monetary policy is the use of interest rates, money supply and exchange rates to influence AD and in the UK, is controlled by the Monetary Policy Committee (MPC) at the Bank of England. When using an expansionary monetary policy, the MPC will ordinarily lower Bank Rate (overnight lending interest rates for commercial banks), which should in turn lower their rates for their customers. This will reduce the cost of borrowing for firms and thus encourage greater investment. As firms invest and expand they will require more workers, which will reduce the rate of unemployment and also increase the level of output in the economy, leading to economic growth. In addition, as unemployment falls, the disposable income for these workers will increase, thus raising their purchasing power and their level of consumption. This will

A straightforward introduction providing succinct, accurate definitions and setting a firm direction for the essay.

Reference to a specific tax – in this case income tax – is helpful as it provides a more nuanced answer than simply discussing lower taxes in general.

It is fairly standard evaluation in macro essays to say that the impact of a change depends on the current macro equilibrium, but many students will simply write that it “depends on the position of the AD and AS curves”. Here, the candidate has linked their evaluation carefully to current context and provided a more detailed answer.

Good current knowledge of UK labour markets shown, helping to raise the answer from AS to A level standard.

Considering two possible routes / chains of analysis shows good depth of understanding.

Inclusion of the multiplier and the accelerator can lengthen and strengthen analytical

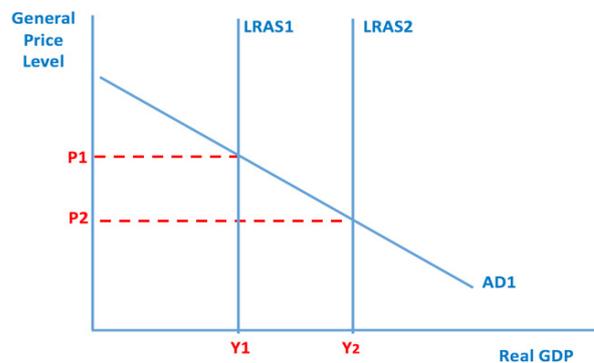
lead to a positive multiplier effect, and also a positive accelerator effect, creating a further boost in AD and economic growth and fall in unemployment.

chains.

However, the main focus of the MPC is to control inflation within the economy, keeping it within the government set symmetric target of 2% \pm 1%. The flexibility of the MPC to lower interest rates to boost AD will therefore be dependent upon inflation being below its target. This reduces the flexibility of monetary policy as a tool in the UK to promote lower unemployment and higher economic growth. The current UK Bank Rate is already historically low, and so alternative approaches such as QE and Forward Guidance have had to be used, although arguably with minimal success as the additional liquidity and confidence injected into the system has not trickled down through the financial sector. In addition, there is said to be a significant time lag of between 18 months and 2 years associated with monetary policy changes and so there will be very little immediate impact felt on the current level of unemployment and growth in the UK when interest rates are first decreased.

By developing the evaluation into consideration of other aspects of monetary policy, the candidate is helping to boost their answer to A level standard.

Supply-side policies could also be used to simultaneously reduce unemployment and raise the UK's economic growth rate. One such supply-side policy could be the promotion of entrepreneurship through the deregulation of markets (a free-market policy). The removal of regulation reduces the barriers to entry, making it easier for new firms to enter the market by making markets more contestable. As the number of firms in the economy increases the demand for labour will increase, reducing unemployment, and the productive potential of the economy will increase, as shown on the diagram. The increase in the productive potential of the economy from LRAS1 to LRAS2 will increase the rate of potential economic growth in the economy, and raises employment.



Contestability is an A level topic rather than AS, and it is good to see the candidate linking more advanced micro topics into a macro essay.

However, the UK economy is still in a fairly weak, although improving, state following the financial crisis and Great Recession, and still currently has a negative output gap. Therefore, an increase in the LRAS may not have a large effect on the current level of output (Y1 in the diagram above) thereby only increasing the potential economic growth rate of the economy and not the actual growth rate. Furthermore, deregulation does not necessarily result in increased contestability; there may remain other barriers to entry, for example, or incumbent firms may be more able to abuse their existing monopoly power. This has certainly been true in many UK transport markets.

Excellent application and evidence here, which is allowing this candidate to build effective evaluation

Which policy is most effective in reducing the UK's level of unemployment at the same time as raising the UK's economic growth rate will depend on several factors. For example, expansionary fiscal policy could adversely affect government finances, and so its use will be constrained during periods of recession unless the government borrows more. Current UK national debt is around \$1.6tr which has led to a period of austerity despite low growth rates and relatively high unemployment rates. So, the effectiveness of fiscal policy as a means to promote growth and employment is reduced. In addition, policy effectiveness will depend upon the current level of spare capacity in the economy. If the economy is near full capacity then expansionary demand-side policies will have little impact on either the unemployment rate or the economic growth rate. Here, supply-side policies will be more effective in raising the productive potential of the economy and promoting long-term growth in the economy.

The "it depends on" statements are followed by clear explanations of their relevance.

By using a combination of expansionary demand-side policies and supply-side policies a sustainable rate of economic growth can be achieved which will lead to a fall in the long-term rate of unemployment.

A succinct but supported judgement is reached.