**Economics CSQ – Chapter 6 – Role of Government in an Economy – Aims of Government; Fiscal, Monetary and Supply-side Policies – Q1**

**Pakistan aims to increase its rate of economic growth**

The annual rate of economic growth in Pakistan has until recently averaged 5.8%. This high rate of economic growth has been largely due to a change in the contribution of the different industrial sectors to Gross Domestic Product (GDP). By 2011, the proportion contributed by the primary sector had fallen to 20% and by the secondary sector to 27%, while the proportion contributed by the tertiary sector rose to 53%.

However, the Pakistan Institute of Development Economics (PIDE) is concerned about the rate of economic growth in the country now and in the future. The annual growth rate had fallen to 2.6% in 2011 and it was not expected to rise above that figure in the next few years. The PIDE was asked to suggest how the rate could be substantially increased.

The PIDE recommended the use of monetary policy, through lowering interest rates and increasing the money supply, to stimulate growth. It was concerned, however, that such a policy, while encouraging growth, could increase the inflation rate. In 2011, the rate of inflation in Pakistan was 13.2%. The PIDE therefore tried to find other ways to encourage an increase in the country’s rate of economic growth.

1. Explain how the use of monetary policy, through lowering interest rates and increasing the money supply, could be used to stimulate the rate of economic growth in a country. [5]
2. Discuss whether other policies, apart from monetary policy, might be more successful in raising the rate of economic growth in Pakistan. [6]

**Suggested Answers**

**(a) Explain how the use of monetary policy, through lowering interest rates and increasing the money supply, could be used to stimulate the rate of economic growth in a country. [5]**

Explain how lowering the rate of interest will stimulate economic growth rate

Lowering of interest rates will make borrowing cheaper will reduce the reward from saving and therefore be likely to increase spending and so increase demand and output

Explain how increasing the money supply will stimulate economic growth rate

Increase in the money supply to make funds more available with more money. Therefore, people are likely to spend more again contributing to an increase in demand and output

**(b) Discuss whether other policies, apart from monetary policy, might be more successful in raising the rate of economic growth in Pakistan. [6]**

Explain why other policies may be more successful than monetary policy in raising economic growth rate

* fiscal policy through lowering taxes and/or increasing expenditure higher government spending on schools and hospitals will directly increase output lower income tax will increase disposable income which may raise consumer expenditure encouraging firms to produce more
* supply-side policy measures are designed to increase the output potential of the country education and training may increase productivity subsidies/lower corporation tax may increase investment privatisation may increase efficiency deregulation can reduce firms’ costs of production
* some fiscal policy measures can increase both total demand but also total supply
* supply-side policy measures can allow growth to occur over time can allow growth to take place without inflation can increase the economy’s international competitiveness improving the current account position
* supply-side policies that remove trade restrictions attract foreign investors which leads to increased capacity higher output/income and leads to economic growth.

Explain why monetary policy may be more successful than other policies in raising economic growth rate

* fiscal policy measures can take time to have an effect, e.g. takes time to pass the necessary legislation and for people to respond to the changes
* people and firms may not respond as expected to fiscal policy measures, e.g. if people lack confidence they may not spend more as a result of a cut in tax
* supply-side policy measures can take a very long time to have an effect, e.g. increased spending on education make take 10–15 years to have an impact on productivity
* supply-side policy measures may not work, e.g. privatisation may lead to inefficiency in the case of a private sector monopoly
* supply-side policy measures can be very expensive, e.g. raising the school leaving age