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**Previous Homework- answers**

5 **Extract B** (lines 11–12) states: 'In response, as inflation rose above the target rate, the Bank of England's Monetary Policy Committee acted by increasing Bank Rate.'

Explain how an increase in Bank Rate may lead to a reduction in the rate of inflation.

**[10 marks]**

**Higher interest rates reduce consumption**

Bank Rate ↑ → commercial banks raise loan & mortgage rates → monthly repayments ↑ → disposable income ↓ → consumption ↓ → AD shifts left → demand-pull inflation falls.

**Context:** Extract B shows mortgage repayments increased when Bank Rate rose.

**Higher interest rates reduce investment**

Bank Rate ↑ → cost of borrowing for firms ↑ → fewer loans for capital investment → investment ↓ → AD ↓ → less spending pressure in economy → inflation falls.

**Context:** Business investment already declining (Extract C) → higher rates reduce AD further.

**Extract C** (lines 17–18) states: 'These policies could restrict economic growth in the short term and increase the likelihood of the economy going into recession.'

Use the extracts and your knowledge of economics to evaluate policies that might help an economy to recover from a recession.

**[25 marks]**

Expansionary fiscal policy (G↑ or tax↓)

Government spending ↑ → incomes ↑ → consumption ↑ → AD shifts right → real GDP ↑ → unemployment ↓ → economy moves out of recession.

Tax cuts ↓ → disposable income ↑ → household spending ↑ → AD ↑ → faster recovery.

**Context (from extracts):**
Retail sales ↓ 3% and investment ↓ 2.5% → suggests demand is weak.

**Evaluation:**

High borrowing (forecast 106.7% of GDP) → limits ability to expand G → risk of worsening debt → might increase long-term interest rates.
Also: inflation high → fiscal expansion could add more demand → risk of worsening inflation.
→ Fiscal policy may help short-term but has **budget constraints + inflation risk**.

**Monetary policy (cutting interest rates)**

**Chain of analysis:**
Interest rates ↓ → borrowing cheaper → mortgages ↓ → disposable income ↑ → consumption ↑ → AD ↑ → GDP ↑ → recovery strengthened.

Interest rates ↓ → cost of borrowing for firms ↓ → investment ↑ → AD ↑.

**Context:**
Business investment already falling → lower rates could reverse this decline.

**Evaluation:**

Extract B shows interest rates were being raised to fight inflation → cutting now could make inflation worse → weakens currency → imported inflation ↑.
Also: confidence may be low → even if rates ↓, people may not borrow → **monetary policy can be weak in a recession (liquidity trap-type behaviour)**.

## Micro 2023 Exam Paper 1 AS AQA

**Q25 (10 marks)**

**Explain how the development of renewable energy sources is likely to affect the market for oil.**
*(Given in pure chain-of-analysis style — no evaluation needed)*

**Point 1 — Substitutes reduce demand for oil**

Renewables ↑ → households & firms switch away from oil → demand for oil ↓ → demand curve shifts left → price of oil falls → quantity traded falls.

**Point 2 — Lower demand due to environmental policy**

Governments encourage renewables (subsidies / taxes on fossil fuels) → relative price of renewables ↓ → oil becomes less competitive → demand for oil ↓ → lower revenue for oil producers.

**Point 3 — Long-run reduction in dependency**

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Electric cars, solar and wind become more widespread → oil used less for transport and electricity → long-term decline in oil demand → reduced price volatility in future.

**Context links (from Extract C):**

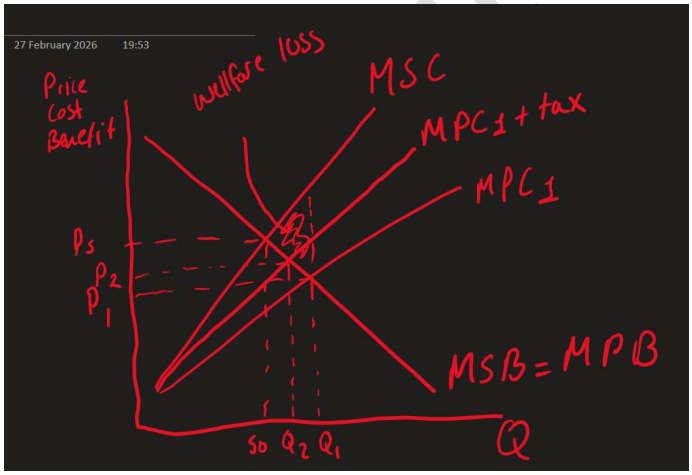
- Renewables becoming cheaper (solar/wind).
- Governments using taxes/regulation to reduce oil use.
- Electric cars increase demand for substitutes.

**Q26 (25 marks)**

**Evaluate ways in which governments could deal with market failures in the oil industry.**

**Point 1 — Carbon taxes on oil (to internalise externalities)**

**Oil consumption produces pollution and greenhouse gas emissions → negative externalities → MSC > MPC → too much oil produced in free market → tax shifts supply left → reduces production → closer to Social optimum level..**




**Evaluation:**

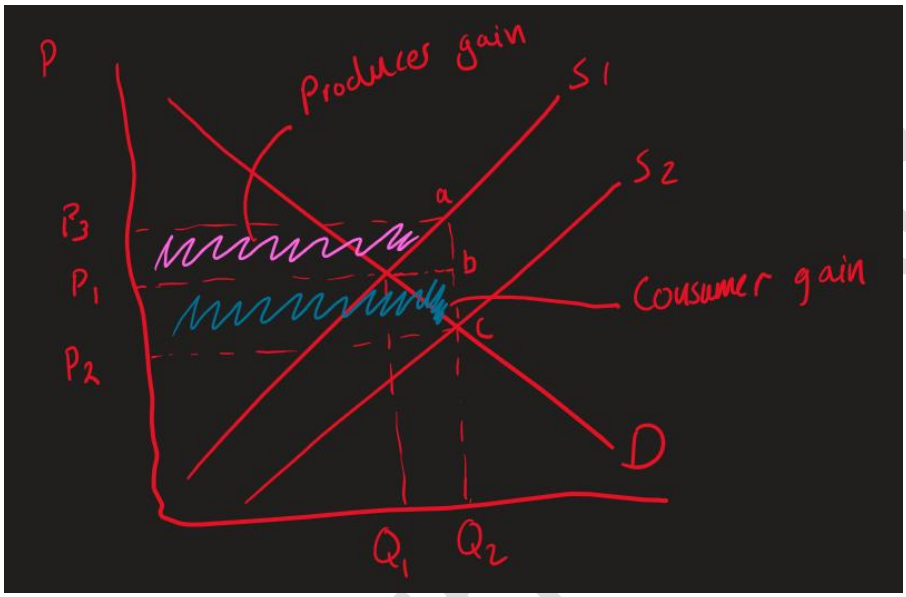
**High taxes raise fuel costs → may cause political backlash (e.g., Gilets Jaunes in France).**
**Oil demand is inelastic → large tax needed for big effect → regressive impact on low-income households.**

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**Point 2 — Subsidies for renewable energy (promote substitutes)**

**Renewables cheaper → households/firms switch away from oil → demand for oil ↓ → lower emissions.**

**Innovations → LRAS ↑ → long-run sustainability.**
**Extract C: growth of solar/wind, electric cars.**




**Evaluation**

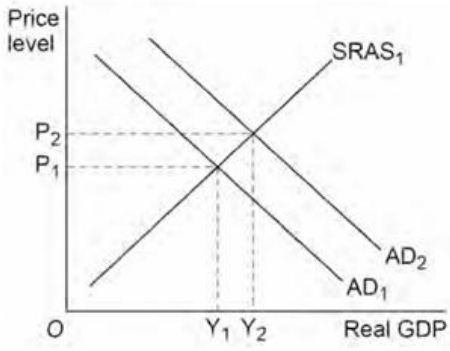
**Subsidies expensive → increases government spending.**

**May distort markets → risk of "picking winners".**

**Long-term impact slow → oil still needed in the short run.**

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## Micro 2023 Exam Paper 2 AS AQA




**Q31 (10 marks)**

**Explain how a fall in a country's international competitiveness may affect economic growth.**

Introduction

International competitiveness refers to a country's ability to sell its goods and services at attractive prices and quality in global markets. A fall in competitiveness can affect both aggregate demand and long-term productive capacity.

Point 1 — Reduced exports → lower aggregate demand

If UK goods become less competitive due to higher prices or lower quality, exports will fall. This reduces aggregate demand because exports are a component of AD. Lower AD leads to lower real GDP growth and possibly higher unemployment.

Chain:
Competitiveness ↓ → exports ↓ → AD ↓ → GDP ↓ → slower economic growth.

Point 2 — Worsening balance of trade → leakages from circular flow

A fall in competitiveness may increase imports as consumers switch to cheaper foreign goods. This worsens the balance of trade and creates a leakage from the circular flow of income, reducing national income.

Chain:
Imports ↑ → X–M worsens → national income ↓ → growth ↓.

**Q32 (25 marks)**

**Evaluate policies that may be used to achieve a sustained improvement in the UK's balance of trade in goods and services.**

Introduction

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The balance of trade depends on the competitiveness, productivity and demand conditions at home and abroad. A sustained improvement requires long-term changes in export performance and import competitiveness. Policies may include supply-side measures, exchange rate policy, and demand-side adjustments.

Point 1 — Supply-side policies to improve competitiveness

Improving productivity through education, training and investment in modern technology makes UK goods higher quality and lower cost. Extract F mentions that better-skilled workers can produce competitive, high-quality goods sought globally. This improves exports and reduces reliance on imports.

Evaluation:
Supply-side policies take many years to work and require high government spending. They may be ineffective if global demand is weak or if UK industries face strong foreign competition.

**Point 2 — Reducing corporation tax / investment incentives**

Lower business taxes encourage firms to invest more, improving efficiency and innovation. This can raise export competitiveness and improve the trade balance. Extract F highlights how corporation tax changes can influence exporting firms.

**Evaluation:**
Lower taxes reduce government revenue and may worsen public finances. Firms may also use tax savings for dividends rather than investment, limiting effectiveness.

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