

Economics

Advanced GCE **A2 7812**

Advanced Subsidiary GCE **AS 3812**

Mark Schemes for the Units

January 2010

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Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

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Subject-specific Instructions

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Candidates should be regarded as achieving the highest level of response which accurately describes their answer. They do not necessarily pass through all lower levels but it is usually expected that higher level responses will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, ie a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 6 Quality of Written Communication will be assessed in the Section B essay.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

Level 4

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

Levels 2 and 3

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

Level 1

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only as in Section B of all A2 optional units.

2884 Economics of Work and Leisure

Section A

- 1 (a) Fig.1 indicates the extent to which different categories of occupations in the UK are paid different amounts.

(i) Compare the median pay in 2007 of health professionals, skilled manual workers and retail sales assistants.

1 mark each for each valid comparative statement – e.g. health professionals' pay is more than twice that of skilled manual workers, which in turn is more than twice that of retail sales assistants. The crucial point is that statements must be comparative to gain credit, but only 1 mark if an answer merely states overall rank order. **[2]**

(ii) Define the term marginal revenue product of labour.

Marginal revenue product [MRP] of labour measures the addition to revenue of a firm from employing one more [or the last] unit of labour. 1 mark for the correct idea only, 2 marks for an accurate statement. **[2]**

(iii) State and explain one possible reason why the average professional worker is paid more than twice the average administrative and secretarial worker.

One reason/explanation only required. In essence, 1 mark for identifying a valid reason plus up to 2 further marks for a valid explanation of it – the explanation must link explicitly to the stated wage differential for the full 3. The two best explanations would be either in terms of different values of MRP, and so Demand, for the two occupations, or in terms of differences in their Supply. **[3]**

- (b) Using the information provided, explain one possible effect of wage differentials on the operation of the labour market.**

In Fig.2, the relevant effect is in the area of motivation of workers, and so presumably productivity, whereas in Fig.3 it is recruitment or responsiveness of the labour market to occupational shortages. For either, 1 mark for identification of the relevant effect, plus up to 2 further marks for explanation of how it effects the operation of the labour market.

NB A maximum of 1 if an answer identifies an effect which is not related to the case material. **[3]**

- (c) Comment on the plans (Fig. 3) to reduce skills shortages by recruiting older workers.**

Up to 2 marks for an explanation of how the plan might achieve the stated objective. A further 2 marks are then available for a relevant 'comment'; this might, for example, focus on alternative ways of filling skill shortages [e.g. recruitment overseas], or perhaps express doubts about the effectiveness of recruiting older workers. **[4]**

- (d) Discuss the extent to which private firms should be solely responsible for training the workers they need.

Fig. 4 relates explicitly to the issue of training by private firms in areas of skills shortages, although Fig. 3 is also of some relevance. There are arguments in favour of private firms training their own workers - for example, they know best what are their precise needs, and can assess benefit against cost directly. However, there are clear positive externalities of such action by private firms - and so a case for some subsidisation, perhaps, and there is also a 'free rider' issue, and so perhaps a case for direct government provision.

- L2** For a two-sided discussion, which both considers benefits of private firm training provision [max. of 3 if this is all that is done], and also looks at disadvantages. There should be a maximum of 4 if the 'extent to which' and 'solely' aspects are ignored

3-6

- L1** For an answer which explains the basis for private firms training the workers they need

1-2

[6]

Section B

- 2 (a) Explain how a perfectly competitive industry is economically efficient. [10]**

Characteristics of a perfectly competitive industry - large number of firms, price-takers, free entry, perfect knowledge, homogeneous products. Explanation of price and output - determination, with appropriate diagrams; in both short- and long-run, with explanation of the two time periods. Explanation of economic efficiency, incorporating both productive and allocative efficiency. Explanation of the efficiency characteristics in perfect competition in the long-run – ie $P = MC$ and P at the minimum of the AC curve.

- Level 3** Clear explanation of both price/output determination and long-run efficiency

7-10

- Level 2** Limited understanding only, either of price/output determination or of efficiency

4-6

- Level 1** Knowledge of perfect competition characteristics only

1-3

- (b) For a leisure market of your choice, discuss the extent to which there is an efficient allocation of resources. [15]

Selection of chosen leisure market - which may be, but does not need to be, one of the four named in the specification. Explanation of its market structure and the way in which prices and output are determined in it. Consideration of efficiency in the market/industry, linked to market structure, with both productive and allocative efficiency covered. Discussion of 'extent' - with other issues [e.g. economies of scale, dynamic efficiency, X-efficiency, non-profit-maximisation objectives] also considered.

Level 4	Evaluative discussion, focused on 'extent' of efficient allocation of resources in chosen market. There should be a maximum of 12 if an answer fails to address at least one of the stated 'other issues'	9-15
Level 3	Explanation of efficiency in the chosen leisure market	6-8
Level 2	Application of market structure [or contestability] to the chosen market	3-5
Level 1	Descriptive points on the chosen market	1-2

[NB An answer could be expressed in terms of contestability rather than market structure, and this is fine, though only if it also analyses the extent of efficiency acceptably too]

- 3 (a) Explain possible consequences of labour market failure. [10]

Characteristics of a perfectly functioning labour market, in terms of perfect knowledge, free entry, homogeneous factors, wage takers. Meaning of labour market failure, as non-achievement of optimum allocation of labour resources - examples to illustrate reasons for such failure would include trade unions, information failure, monopsony power, immobility. Consequences of such failure, in terms of non-competing labour markets, persistent wage differentials, unemployment, inequality, etc.

Level 3	Clear explanation which links nature of labour market failure to effects/consequences	7-10
Level 2	Limited explanation of effects or good explanation of failure only	4-6
Level 1	Knowledge of labour market failure or of characteristics of perfect market only	1-3

- (b) Discuss the likely effectiveness of government policies that aim to make the labour market more flexible. [15]

Meaning of labour market flexibility, in terms of market responding effectively to change - for example labour being mobile geographically and occupationally. Identification and explanation of policies aimed to increase labour market flexibility - reducing occupational and geographical mobility by training, subsidies, etc., improving information flow, removal of trade union barriers, use of fiscal system, etc. Discussion of possible effectiveness of policies, in terms of their objectives in mitigating extent of labour market failure by increasing flexibility. Evaluation can be both within and between policies, or indeed related to the increased flexibility objective.

Level 4 For evaluative discussion, focused on effectiveness relative to objectives. There should be a maximum of 12 if an answer fails to consider the effectiveness of at least two policies. **9-15**

Level 3 For explanation of valid policies, linked to increasing flexibility **6-8**

Level 2 For application which links policies to their effects on the labour market **3-5**

Level 1 For some knowledge of relevant policies only **1-2**

- 4 (a) Explain why wealth in the UK is unequally distributed. [10]

The meaning of wealth. Identification of what constitutes inequality of distribution of wealth. Identification of factors which contribute to wealth being unequally distributed - for example, inequality of income [and so factors which cause this], inheritance, different attitudes to saving, government fiscal policy; in each case, an explanation of a factor should link explicitly to how it results in inequality of wealth.

Level 3 For clear explanation of a range of factors, linked to wealth inequality **7-10**

Level 2 For limited explanation only of at least one relevant factor **4-6**

Level 1 For knowledge of wealth only **1-3**

- (b) Discuss the view that progressive taxation of income is the best long-term way to reduce the extent of inequality of wealth. [15]

Explanation of meaning of 'progressive', including in the context of taxation of income. Explanation of effect of use of progressive taxation of income on extent of income inequality, and hence also on the extent of inequality of wealth. Identification and explanation of at least one other possible policy aimed to reduce inequality of wealth - for example, inheritance taxation, fiscal incentives to save. Evaluation could be of individual policies - effectiveness in achieving the objective, undesirable side-effects; but it should also be between policies, given the required focus on 'best', and 'in the long-run'.

Level 4	For evaluative discussion, focused on the best long-run method of reducing wealth inequality. There should be a maximum of 12 if an answer fails to compare explicitly at least two policies	9-15
Level 3	For explanation of the working of relevant policies	6-8
Level 2	For application linked to progressive income taxation	3-5
Level 1	For knowledge only of wealth-income distinction	1-2

Specification Grid											
	Question 1						Questions 2, 3, 4				
	a(i)	a(ii)	a(iii)	b	c	d	Total	a	b	Total	Overall
AO1		2	1	1			4	3	2	5	9
AO2	2						2	3	3	6	8
AO3			2	2	2	2	8	4	3	7	15
AO4					2	4	6		7	7	13

Specification section	Q1	5.4.1 & 5.4.3 & 5.4.4
	Q2	5.4.2
	Q3	5.4.4
	Q4	5.4.4

2885 Transport Economics

Section A

- 1 (a) Explain why the demand for transport into central London is a derived demand. [2]

Idea of transport not demanded for its own sake, but to meet some other purpose (1)
Application to transport into central London such as developing concept of journey purpose (work, school, leisure, visiting friends and family etc.) (1)

- (b) Increased road use creates externalities in the form of congestion. Explain the external costs imposed on: [4]

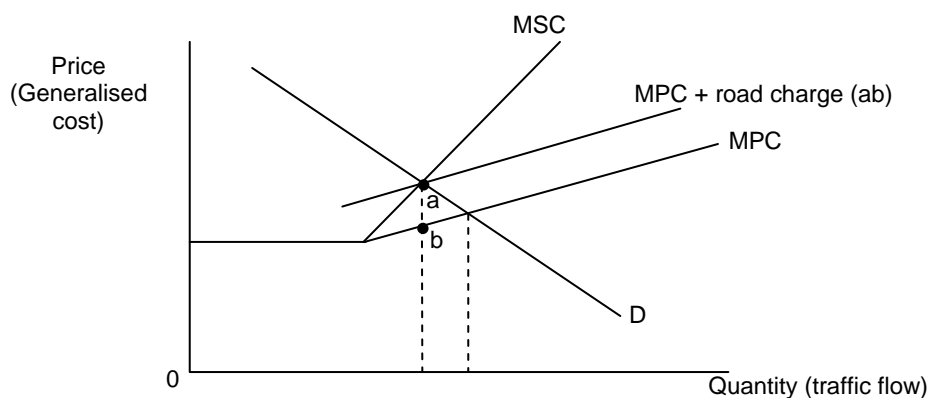
- (i) local bus companies,
(ii) their passengers.

For understanding that external costs are costs imposed on third parties applied to:

- (i) local bus companies; costs higher (1) due to for eg increased fuel and maintenance costs (1) or revenue lower (1) due to loss of bus mileage (1)
(ii) their passengers; delays for work/leisure (1) idea that time is money/opportunity cost (1)

- (c) With the aid of a diagram, explain how the congestion charge has resulted in a reduction in the number of vehicles entering the charging zone. [4]

Explanation in terms of increasing price of road use, shifting supply curve to the left, and therefore reducing number of vehicles entering London.



Up to 3 marks for diagram, up to 2 marks for explanation without diagram.

- (d) Comment on the use of one policy, other than the congestion charge, that could result in a reduction in the number of vehicles entering central London. [4]**

Number of possible alternatives could include banning traffic, increased licensing, traffic management.

1 mark for knowledge of which policy could be used to reduce the number of vehicles entering central London e.g. traffic management.

1 mark for explanation of how that policy can achieve reductions e.g. increasing inconvenience.

2 marks for evaluative comment e.g. policy may not achieve aim due to low PED, high YED of vehicle use due to lack of alternatives for some; measure could be unpopular. Comments need to be clearly underpinned by appropriate theory for 4 marks.

For an alternative road pricing system the differences to congestion charging must be clearly explained to gain 4 marks.

- (e) Discuss the extent to which the congestion charge contributes towards a more sustainable transport system in central London. [6]**

A basic principle of congestion charge is that users should pay the costs they impose on others allowing the market mechanism to allocate traffic more efficiently between differing modes. Explanation required in terms of internalising external costs.

Discussion could take the form of whether this is sustainable although a better approach would assess how sustainable.

An approach is to compare the congestion charge with other policies or as a package to encourage more sustainable modes of transport. Proceeds could be hypothecated into public transport in urban areas or to subsidise rail freight for inter-urban schemes.

- L2** For a discussion of the contribution that the congestion charge can make towards a sustainable transport policy – needs to make a critical assessment of its contribution at top end. **3-6**

- L1** For an analysis of the congestion charge as a sustainable transport policy. **1-2**

Section B

- 2 (a) Explain why economists are concerned about firms increasing their market share in an industry. [10]

Understanding of increased market share in terms of concentration; possibility of increased market power, general monopoly argument/removal of competition, predatory pricing, increased prices, poor service levels etc; resource misallocation in terms of underproduction, cost increases, X inefficiency. Reward use of diagram.

Level 3 For an explanation of economists concern over increasing market share. 7-10

Level 2 For an understanding of the problems of increased market share, perhaps with some application. 4-6

Level 1 For a few general points for e.g. related to monopoly power. 1-3

- (b) Discuss the extent to which air passenger transport is a contestable market. [15]

An understanding of the characteristics of contestable markets; few barriers to entry leading to many potential entrants, threat of entry, few barriers to exit, low exit costs. Application to air passenger transport – barriers to entry exist (operating licence, set up costs – but can sell assets) ownership of take –off/landing slots, ticketing arrangements for example through alliances. Evaluation in terms of judgement of extent of contestability.

Level 4 For a discussion of the extent to which the air passenger transport industry is a contestable market. 9-15

Level 3 For an analysis of the issues of contestability within the air passenger transport industry. 6-8

Level 2 For an application of contestable market theory to the air passenger transport industry. 3-5

Level 1 For some knowledge of contestability or the air passenger transport industry. 1-2

3 (a) Explain the economic arguments in favour of heavier road goods vehicles. [10]

The main basis of the argument is economies of scale. Many of the costs of large goods vehicles are fixed costs e.g. overheads, depreciation, licences, insurance or semi-fixed costs (not entirely dependent on the use made of the vehicles) e.g. driver's wages. Therefore the average cost per tonne of payload falls as the vehicle size increases. Could consider different types of economies, mainly technical via increased dimensions but others also apply.

Additional economic arguments; fewer vehicles needed to carry same tonnage, therefore less congestion, fuel and time savings, possible external benefits and certainly environmental benefits.

L3 For a clear explanation of the economic arguments in favour of increasing the maximum permitted lorry weight. **7-10**

L2 For an understanding of at least one economic argument in favour of increasing the maximum permitted lorry weight. **4-6**

L1 For some knowledge of benefits of heavier goods vehicles. **1-3**

(b) Discuss the effectiveness of using indirect taxation to make goods vehicles pay the full social costs of their use. [15]

Explanation of track costs argument (term not required). Possible use of diagram to show internalisation of external cost via pollution taxes and/or congestion charges with appropriate explanation in terms of reducing overconsumption and therefore contribute to a more efficient resource allocation; social efficiency particularly if full social costs are correctly identified.

Discussion in terms of difficulties in assigning monetary values to external costs; inflationary consequences of increasing costs of freight transport; inelastic demand due to lack of viable alternative freight modes for many journeys; need for increased capacity of alternatives.

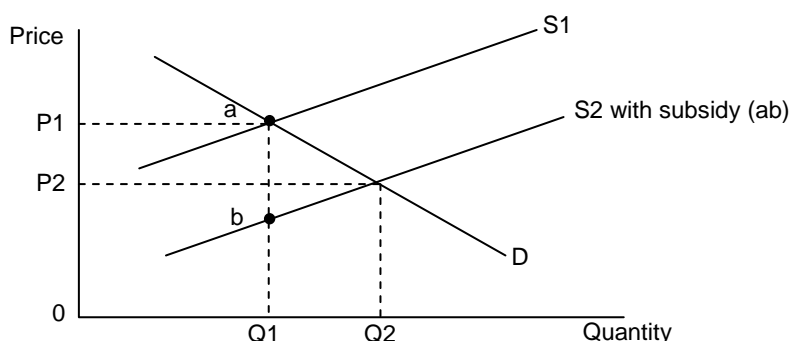
Level 4 Discussion of the effectiveness of using indirect taxation to make goods vehicles pay the full social costs of their use. **9-15**

Level 3 Explanation of how indirect taxation can be used to make goods vehicles pay the full social costs of their use. **6-8**

Level 2 Application of knowledge and critical understanding of how indirect taxation can be used to make goods vehicles pay the full social costs of their use. Will lack analysis. **4-6**

Level 3 Knowledge of effect of indirect taxation or social costs. **1-3**

- 4 (a) With the aid of a diagram, explain the effects of subsidies paid to train operating companies. [10]



Subsidy has the effect of increasing supply. Diagram as above (reward alternatives) with explanation of effects on price and quantity. Impact dependent on PED. However subsidies main use has been to cover shortfalls in covering costs. Therefore subsidy may simply prevent closure of some routes and not reduce overall fares. Some subsidies directed at certain groups e.g. pensioners and students for social equity reasons and should decrease fares for these groups.

Level 3 For an explanation with accurate diagram of the effects of subsidies paid to train operating companies. **7-10**

Level 2 For an understanding of the effect of subsidies paid to train operating companies (or above without accurate diagram). **4-6**

Level 1 For some knowledge of effects of a subsidy. **1-3**

- (b) Discuss the effectiveness of using subsidies to promote a switch of travellers from private cars to public transport. [15]

Main arguments for subsidising public transport are social equity, positive externalities such as reduced congestion and environmental pollution, urban regeneration – but they may be inefficient; lack of motivation to keep costs down, blanket nature of subsidies.

Evaluation; if reduction of car use is desired then subsidy may only be part of solution with road user charging, or if aim is to simply increase public transport usage to prevent social exclusion etc. may need to target subsidy at increasing reliability, convenience, comfort etc. (to increase PED and XED) rather than reducing fares. Also problem of local bus services being an inferior product. Use of government money needs to be accountable.

Level 4 For a discussion of effectiveness of using subsidies to promote a switch of travellers from private to public transport. **9-15**

Level 3 For an explanation of how subsidy can switch passengers from private to public transport. **6-8**

Level 2 For an application of knowledge of how subsidy can switch passengers from private to public transport. Will lack analysis. **3-5**

Level 1 For some knowledge of problems of subsidies. **1-2**

Specification Grid										
	Question 1						Questions 2, 3, 4			
	a	b	c	d	e	Total	a	b	Total	Overall
AO1	1		2	1		4	3	2	5	9
AO2	1	2				3	3	3	6	10
AO3		2	2	1	2	7	4	3	7	13
AO4				2	4	6		7	7	13

Specification section	Q1	5.5.1 & 5.5.4
	Q2	5.5.2
	Q3	5.5.3 & 5.5.4
	Q4	5.5.3 & 5.5.4

2886 Economics of Development

Section A

- 1 (a) Using Fig. 1, identify the two main policies which led to the UK being ranked below the Netherlands.

Foreign aid (1) and migration (1) [2]

- (b) With reference to Fig.1, what conclusions may be drawn about the change in the nature of Japan's relationship with the developing world since 2003?

It is less outward-looking/supportive e.g. foreign aid, trade/imports (1), it is more protected/isolated e.g. trade, security, migration, (1) it is more helpful on developed specialities e.g. investment, technology (1) and overall its commitment is lower with a reduced average (1). Any three points, reward other valid descriptors which reflect statistics. [3]

- (c) Explain two forms of trade protection which might be penalised in the CDI scoring system.

High levels of tariffs (import taxes) that make developing countries exports less competitive in developed countries' markets (2), the use of quotas (quantitative limits) that restrict the amount of exports from developing countries (2), high levels of domestic subsidies that enable developed countries to undercut and disrupt developing countries' production (2), interference with the exchange rate to gain competitive advantage by undervaluation (2). Credit other possibilities. Each point must be clarified to gain 2 marks; recognition of 2 points gives 2 marks maximum. [4]

- (d) Comment on whether tied aid should be penalised in the CDI.

Tied aid has conditions attached by the donor (1), example of typical nature of conditions (1), this may prevent aid being put to the best or priority use and may prevent deals being negotiated on the best financial terms (2), tied aid may have beneficial aspects, such as helpful direction and avoidance of misuse (2), reasoned conclusion (1) to 5 marks maximum. [5]

- (e) Discuss the value to the development process of publishing information such as the CDI.

Possible benefits: it provides detailed information which may inform policy decisions by governments and educate public opinion, may encourage pressure group activity to promote development and may encourage/shame governments to recognise areas of weakness and improve their performance on development. Possible drawbacks: the nature of the scoring process is subjective, the selection of criteria may be arguable, it covers a restricted range of countries, it is based upon a particular view of development, its effect is limited because it is not well known and it can be ignored or used selectively. Full marks require some awareness of both sides, otherwise 4 marks maximum. [6]

Section B

- 2 (a) Explain the global differences found in the achievement of sustainable development. [10]**

Sustainable development is the ability to meet the needs of the present generation without compromising the needs of future generations. It involves the stock of capital assets remaining at least constant and includes maintaining the state of the environment. The sustainability of development reflects the quantity and quality of resources given over to reducing non-sustainable development and the pressures causing non-sustainable development. The wealth of developed economies allows them to use effective modern technology and to avoid the more destructive processes. The immediate needs of the developing world stress growth with its accompanying externalities and depletion of resources. China's position can be compared to that of the USA.

L3 For an explanation of global variations in sustainable development (7-10)

L2 For application of knowledge and critical understanding of sustainable development (4-6)

L1 For knowledge and understanding of sustainable development (1-3)

- (b) Discuss the impact of multinational companies on the ability of countries to develop. [15]**

Multinationals own or control assets in countries outside of their home economy. Their motivation is profit maximisation, the majority originate from developed countries and they operate on a global scale. Their benefits include foreign investment, the introduction of technology and training, employment opportunities, efficient production methods, increased export ability, tax revenue and stimulation of local industry. Against this can be set low skilled employment, inappropriate technology, exploitation of resources, undue influence on government, damage to local producers, tax avoidance, poor labour conditions, profit remittance and the introduction of foreign values. Benefits may relate to growth rather than development. Some companies may employ a more ethical approach. A higher L4 answer will be able to quote examples of actual behaviour and make a clear link to development.

L4 For a discussion of the impact of multinationals on development (9-15)

L3 For an analysis of the impact of multinationals on developing countries (6-8)

L2 For the application of knowledge and critical understanding of multinationals (3-5)

L1 For knowledge and understanding of multinationals (1-2)

- 3 (a) **Explain the relevance of comparative advantage to a country's rate of economic development.** [10]

Comparative advantage exists where a country has a lower opportunity cost in terms of real resources in the production of a good or service. A country should specialise where it is relatively efficient and trade to maximise benefit. It may benefit from economies of scale and increased output. This may be shown numerically. It will be based on the nature of resources available to a country. It should raise economic growth and living standards, so contributing to economic development. Obstacles to trade may limit the effectiveness of trade and prevent comparative cost theory from working to maximum effect.

- L3 For an explanation of comparative advantage's relevance to development (7-10)
 L2 For application of knowledge and critical understanding of comparative advantage (4-6)
 L1 For knowledge and understanding of comparative advantage (1-3)

- (b) **Discuss the use of a policy of import-substituting industrialisation by the government of a developing economy.** [15]

ISI is based on the domestic production of goods which were formerly imported. This involved tariffs, subsidies, an overvalued exchange rate and import controls to protect the domestic market. This usually started with consumer goods production and was then intended to move to the manufacture of investment goods. The intention was to tackle balance of trade deficits, unfair trading terms and create growth through industrialisation. Infant industries would be able to mature behind trade protection, gain economies of scale and be able to export. This was not a successful policy as involved excessive government intervention and created high cost inefficient producers who were unable to export. The policy runs counter to comparative advantage and agriculture tended to be neglected with the concentration on manufacturing. The benefits of international trade, which include greater choice, cheaper products and higher living standards, were lost. There is an opportunity cost to the government expenditure and it may lack sufficient funds to operate on a large enough scale. A large element of the benefit goes to foreign firms who establish within the trade barriers and gain from tax incentives. History suggests that involvement in international trade has been a major influence in long term growth and prosperity. Inward looking policies have sometimes failed and held back economic development. A higher L4 answer will show awareness of the poor performance of the strategy for current developing economies such as Brazil and India and its success for the Asian Tigers when preceding EOI.

- L4 For a discussion of the choice of a policy of import-substituting industrialisation (9-15)
 L3 For an analysis of the implications of import-substituting industrialisation (6-8)
 L2 For the application of knowledge and critical understanding of import-substituting industrialisation (3-5)
 L1 For knowledge and understanding of import-substituting industrialisation (1-2)

- 4 (a) **Explain why developing countries generally have low levels of labour productivity.** [10]

Labour productivity is output per worker (total output/no of worker hours or years). Productivity depends upon factors such as the quantity of complementary factors available, the health and education of the factor, attitudes of workers and management and national infrastructure. The weaknesses of developing countries reflect their level of development. They may lack up to date technology, have insufficient capital funds and capital equipment, may have poor levels of human capital, traditional social attitudes and may lack institutional support e.g. laws on private property, banking structures and efficient administration all of which hamper their ability to raise productivity.

- L3 For an explanation of factors in a developing economy which affect productivity (7-10)
 L2 For application of knowledge and critical understanding of the influences on labour productivity (4-6)
 L1 For knowledge and understanding of labour productivity (1-3)

- (b) **Discuss the significance for developing countries of their relatively great dependence on agriculture and international tourism.** [15]

Agriculture is a significant if declining sector while tourism is growing. They make major contributions to employment and income. Both are based on the existence of comparative advantage, mainly relating to land and labour advantages.

With limited technology agriculture it offers jobs to low skilled workers and provides goods for export. For some it is the basis of subsistence. Specialisation, e.g. cut flowers from East Africa and tropical fruit from Asia, has resulted in success stories. Agriculture suffers from price instability, low income elasticity of demand and long run unfavourable terms of trade. It is also subject to seasonal influences and variable natural conditions.

Tourism is expanding, has a high income elasticity and is labour intensive. It relies on inputs from foreign owned companies, which may limit local job opportunities and profit distribution. It also has increasing environmental impacts.

Reliance on any narrow range of economic activity places an economy at risk from external shocks. Of the two, tourism seems to offer the greater prospects for growth but this will vary between economies. Further diversification into more rapidly growing sectors may be desirable. A higher L4 response will be able to draw distinctions between the performances of the different sectors.

- L4 For a discussion of the implications of agricultural and tourist dependence (9-15)
 L3 For an analysis of the nature of agricultural and tourist dependence (6-8)
 L2 For the application of knowledge and critical understanding of the production pattern of developing countries (3-5)
 L1 For knowledge and understanding of the importance of agriculture and tourism (1-2)

2887 The UK Economy

1 (a) Explain what is meant by:

(i) 'real-take home pay' (line 4); [2]

Pay after the deduction of tax, National insurance and pension contributions (1),
relative to the rate of inflation. (1)
The spending power of a given level of income. (1)

(ii) 'the household savings rate' (line 9); [2]

The rate at which households are saving money and not using it for consumption purposes. (1)
Measured as an amount per time period
eg x £s per month. (1)

(b) Explain in what circumstances the Governor of the Bank of England has to write a letter to the Chancellor. [2]

The MPC has an inflation target of 2% +/- 1% as measured by CPI. (1)
IF inflation lies outside that band the governor of the Bank of England must write a letter of explanation to the Chancellor explaining the circumstances that have caused the target to be missed. (1)
Inflation is above 3% so the Governor must explain why this happened. (1)
Maximum of 2 Marks.

(c) Explain how a 12% depreciation of sterling should support the move away from importing and towards exporting. [4]

1 mark for explaining that a depreciation should lead to a reduction in the foreign currency price of our exports. The second mark for explaining this should lead to an increase in demand as our goods now appear more competitive, so boosting export revenue.

1 mark for explaining that a depreciation should lead to an increase in the price of imports. The second mark for explaining this should lead to a fall in demand as foreign imports now appear less competitive, so reducing import expenditure.

- (d) **Using the information provided, comment on the view that most of the inflationary pressure reported on is of a supply side nature.** [4]

Candidates are likely to support the view and can gain a maximum of two marks in a number of ways. Either award 1 mark each for 2 pieces of evidence to support the view that inflationary pressure was of a supply side nature, e.g. increased energy prices and increased import prices.

OR award 1 mark each for 2 pieces of evidence to support the view that inflationary pressure is less likely to come from the demand side, e.g. slower consumer spending and an increase in savings.

One mark from each approach is equally acceptable.

Second 2 marks for a commentary

Almost all the available evidence points towards cost-push inflation. The only significant influence in the demand side might be export led AD growth. However, on balance, the majority of available evidence would support the view.

- (e) **Discuss the problems of forecasting the rate of inflation in the short and medium term.** [6]

The problems that candidates are likely to discuss include, attempts to forecast changes in aggregate demand, attempts to forecast changes in wage settlements, commodity price increases, external shocks e.g. oil price hikes, and the increasing difficulties attached to the time frame being considered.

Level 3 5-6 marks. If L2 is covered and there is some judgment offered as to the degree to which forecasting inflation rates is a problem.

Level 2 3-4 marks. For an explanation of at least one short term and one medium term problem.

Level 1 1-2 marks. For an explanation of one of the problems of forecasting inflation in the short or medium term.

- 2 (a) **Explain the role of rates of interest and why there are different rates of interest in an economy.** [10]

It is expected that candidates will begin by defining interest rates as the price of money. Then perhaps expand on this by suggesting it is a reward paid to savers and the cost of borrowed funds. The general level of rates is set by the Bank of England's MPC when they announce base rate every month. Savings and lending rates are then set around this base. Of course at times due to the laws of supply and demand in the various money markets, rates may deviate from their general pattern but basically most savings rates will be offered below base and most lending above the base. The rates will direct the use of funds between savers and borrowers and influence levels of consumption and investment.

Then candidates are expected to consider the influence of that amount of money borrowed/saved, time period and risk all become vital elements in establishing the appropriate rate of interest to be charged in the particular circumstance. In other words candidates must clearly recognize that there are a whole range of different rates of interest being paid and charged throughout the UK economy and that many factors influence the actual rate paid.

Level 3 For an explanation of rates of interest and why there are different rates in the UK economy. **(7-10 marks)**

Level 2 For an application of knowledge and critical understanding of rates of interest and/or why there are different rates in the UK economy. **(4-6 marks)**

Level 1 For a knowledge of rates of interest and/or why there are different rates in the UK economy. **(1-3 marks)**

- (b) Discuss the extent to which monetary policy can be considered the best way to achieve the main macroeconomic policy objectives. [15]**

Candidates are expected to pick up the link with part (a) and embellish an analysis of how monetary policy, by interest rate change, money supply control/quantitative easing, credit control or exchange rate policy, might be used to achieve key policy objectives. Then they might consider its potential shortfalls, before going on to consider other policies that may be used to achieve the key objectives. The best candidates will be those that draw a summary conclusion as to the extent to which one set of policies alone can achieve the main macroeconomic goals.

Level 4 For a discussion of the extent to which monetary policy can be considered the best way to achieve the main macroeconomic objectives. **(9-15 marks)**

Level 3 For analysis of the extent to which monetary policy can be considered the best way to achieve the main macroeconomic objectives. **(6-8 marks)**

Level 2 For application of knowledge and critical understanding of the extent to which monetary policy can be considered the best way to achieve the main macroeconomic objectives. **(3-5 marks)**

Level 1 For a descriptive knowledge and understanding of monetary policy and main policy objectives. **(1-2 marks)**

- 3 (a) Explain the impact that discretionary fiscal policy could have on the UK economy. [10]**

It is expected that candidates will begin by explaining what is meant by discretionary fiscal policy and may compare this to the automatic stability that a given budget stance may provide. Candidates should give a detailed explanation of the use of a budget deficit and a budget surplus and the impact these could have on the economy. They should also consider the conditions in which each policy might be deemed appropriate. It is expected that the main focus will be on the Keynesian demand side consequences of such policy, although supply-side impacts are also worthy of merit. Better candidates may even consider the use of a larger, or smaller, balanced budget policy stances and the impact these might have on the economy. A level 3 answer should consider fiscal policy as an economic tool to either boost or dampen economic activity.

Level 3 For an explanation of discretionary fiscal policy and its impact on the UK economy. **(7-10 marks)**

Level 2 For an application of knowledge and critical understanding of discretionary fiscal policy and its impact on the UK economy. **(4-6 marks)**

Level 1 For a knowledge and understanding of discretionary fiscal policy. **(1-3marks)**

(b) Discuss the limitations of fiscal policy as a policy instrument. [15]

It is important that candidates build on the foundation of their answer to part (a) and to avoid repetition. They will probably clarify the effectiveness of the policy in reaching some outcomes. The limitations may include time lags, the size and predictability of the multiplier, crowding in and crowding out, political constraints, etc. Depth of analysis and true evaluative discussion holds the key to a good answer to this part of the question. Candidates may wish to consider the need for alternative/supportive policies. Also another opportunity arises to consider the supply-side consequences of certain fiscal policies and the efficacy of such in the context of the question.

Level 4 For a discussion of the limitations of fiscal policy as a pi. **(9-15 marks)**

Level 3 For analysis of the limitations of fiscal policy as a pi. **(6-8 marks)**

Level 2 For application of knowledge and critical understanding of the limitations of fiscal policy. **(3-5 marks)**

Level 1 For a descriptive knowledge and understanding of fiscal policy. **(1-2 marks)**

4 (a) Explain the main potential causes of a UK balance of payments deficit on the current account. [10]

There are many potential areas that candidates may wish to consider in answer to this question. To gain a level 3 mark a candidate must consider at least two separate causes otherwise a level 2 max mark will apply. Causes may include domestic inflation, lack of competitiveness, an over-valued currency, high levels of domestic demand, globalization, etc. with an indication of which elements are affected. An alternative approach may be to consider the make-up of the current account and consider reasons for a sharp rise in deficit in one area eg trade in goods or net income flows. A mixture of the two is also an acceptable approach.

Level 3 For an explanation of the main potential causes of a UK balance of payments deficit on current account. **(7-10 marks)**

Level 2 For an application of knowledge and critical understanding of a UK balance of payments deficit on current account. **(4-6 marks)**

Level 1 For a knowledge and understanding of the main causes of a current account deficit. **(1-3 marks)**

- (b) Discuss the extent to which a balance of payments current account deficit is a problem for the UK economy. [15]**

Candidates are expected to offer a discussion of the benefits and problems of a balance of payments deficit as relevant to the UK economy. Topics that may be included in such a discussion may include, the scale and trend of the deficit, international competitiveness, increased consumer choice, employment consequences, relief of inflationary pressure, exchange rate effects, growth consequences and the ability to finance the deficit among others. Once again depth of analysis and true evaluative discussion holds the key to a good answer to this part of the question. The best answers will include a conclusion that offers a judgement of when such deficits are and are not problematic.

Level 4 For a discussion of the extent to which a balance of payments deficit is a problem for the UK economy. **(9-15 marks)**

Level 3 For analysis of the extent to which a balance of payments deficit is a problem for the UK economy. **(6-8 marks)**

Level 2 For application of knowledge and critical understanding of the extent to which a balance of payments deficit is a problem for the UK economy. **(3-5 marks)**

Level 1 For a descriptive knowledge and understanding of a balance of payments deficit. **(1-2 marks)**

Specification 2887 January 2010

	Q1ai	aii	b	c	d	e	Q2a	2b	Q3a	3b	4a	b	Total
Ao1	2	2					3	2	3	2	3	2	9
Ao2			2	1			3	3	3	3	3	3	9
Ao3				3	2	2	4	3	4	3	4	3	14
Ao4					2	4		7		7		7	13

2888 Economics in a European Context

1 (a) Using the data in Extract 1, compare:

- Slovakia's economic growth with that of the euro area over the period 2004 – 2008;
- the change in Slovakia's employment with that of Ireland over the period 2004 – 2008. [6]

Synoptic knowledge

Module 2883 – Section 5.3.1 Indicators of national economic performance
(The use of data to measure economic performance)

Section 5.8.2 Economic and Monetary Union (EMU)
(The performance of the eurozone economy)

Outline of content

Summary statement	Quantification
<p>Economic growth</p> <ul style="list-style-type: none"> • Slovakia's rate of economic growth has always been above that of the euro area. • Slovakia's rate of economic growth has increased over the period whereas that of the euro area is broadly stable at 2 – 3% pa • The difference between Slovakia's rate of economic growth and that of the euro area has increased over the period. 	<ul style="list-style-type: none"> • Slovakia's rate of economic growth is 1.5x that in the euro area in 2004 and almost 3x that in the euro area in 2008 • Slovakia's rate of economic growth is always at least 2% points higher than that of the euro area • At one point Slovakia's rate of economic growth is 6x higher than that in the euro area.
<p>Change in employment</p> <ul style="list-style-type: none"> • Slovakia's employment growth is less than that in Ireland over the whole period, with the exception of 2008 • Slovakia employment growth rate rises over the period whereas that in Ireland falls • Employment growth in Slovakia was negative for three successive quarters, whereas that in Ireland has always been positive • Employment growth in both countries generally rises until the 2nd quarter of 2005. 	<ul style="list-style-type: none"> • Employment growth in Ireland halves over the period • Employment growth in Slovakia increase 4x over the period.

1 mark for each summary point

1 further mark for each quantification

Maximum of four marks per indicator – maximum of six marks overall

- (b) Analyse the circumstances in which rapid economic growth, such as that experienced in Slovakia in 2007, might not create inflationary pressures. [9]

Synoptic knowledge

Module 2883 – Section 5.3.2 Aggregate demand and aggregate supply: the determinants of output, employment and prices.

(The constituents of, and influences upon, aggregate demand - consumer expenditure, investment, government spending, exports minus imports. The factors which influence aggregate supply – land, labour, capital and changes in technology. How aggregate demand and supply analysis can be used to illustrate macro-economic problems and issues.)

Outline of content

Definitions/interpretations of rapid economic growth and inflationary pressures (demand pull). Recognition that there are two circumstances in which rapid economic growth does not cause inflationary pressures:

- *existence of spare capacity*
- *growth of aggregate demand at least matched by growth in aggregate supply*

An analysis of these circumstances could take the form of an AD/AS diagram but it need not do for full marks. Analysis can be distinguished from application by the extent to which candidates seek to explain the circumstances with a clear focus on cause and effect. Statements/assertions only should be rewarded in L2 of the mark scheme.

- | | |
|----------------|---|
| Level 3 | For an analysis of the circumstances in which rapid economic growth might not create inflationary pressures. [7-9 marks] |
| Level 2 | For an application of knowledge of the circumstances in which rapid economic growth might not create inflationary pressures or focus on government anti-inflationary policy only. [4-6 marks] |
| Level 1 | For knowledge and understanding of rapid economic growth or inflationary pressures only. [1-3 marks] |

- 2 Comment on the market failures which might arise from greater reliance on the private sector to finance and provide healthcare in Slovakia. [10]**

Synoptic knowledge

Module 2882 – Section 5.2.1 Economic efficiency within competitive markets
(The conditions for efficient allocation of resources including the concepts of allocative, productive and Pareto efficiency.)

Module 2882 – Section 5.2.2 Why markets may not work efficiently
(The causes and consequences of why markets may not work efficiently to include the market failures of externalities, merit goods and information failures.)

Outline of content

There are three broad areas that candidates could focus on in their analysis of the market failures arising from a greater reliance on the private sector to finance and provide healthcare in Slovakia. These are:

- the positive externalities of healthcare;
- market dominance;
- equity issues;
- information failures.

Candidates should clearly analyse the causes and consequences of the market failures. Without a focus on cause and effect candidates will show only an application of knowledge and understanding, resulting in a Level 2 mark. Level 3 responses will clearly explain the consequences of market failure in healthcare in terms of under or over consumption/provision or the cost of provision. Marks awarded in Level 3 of the mark scheme should distinguish between candidates who analyse appropriate market failures in healthcare and those who are able to link the market failures clearly to the financing and provision of healthcare. Given the pre-release of stimulus material it can be expected that some candidates with a degree of sophistication in their treatment of information failures – expect responses which analyse moral hazard, adverse selection and asymmetric information, especially in relation to healthcare insurance markets.

A commentary on the market failures could focus on one or more of the following:

- the relative importance of different market failures;
- the extent to which the market failures can be overcome either by government regulation or by the actions of healthcare providers;
- the importance of healthcare in terms of the labour force;
- the extent to which market failures are more or less significant than government failure in the finance and provision of healthcare;
- the context of Slovakia.

- Level 4** For a commentary on the market failures which might arise from greater reliance on the private sector to finance and provide healthcare in Slovakia. [8-10 marks]
- Level 3** For an analysis of the market failures which might arise from greater reliance on the private sector to finance and provide healthcare in Slovakia. At the bottom of this level, candidates will not distinguish between market failures arising from the private finance of healthcare and those arising from provision. [5-7 marks]
- Level 2** For an application and critical understanding of the market failures which might arise from greater reliance on the private sector to finance and provide healthcare in Slovakia. Responses in this level will either lack any economic underpinning or lack an explanation of both the causes and consequences of market failure in healthcare markets. [3-4 marks]
- Level 1** For knowledge and understanding of market failure only. [1-2 marks]

- 3 Comment on the reasons why Slovakia has attracted increased foreign direct investment since it joined the EU in 2004. [15]**

Synoptic knowledge

Module 2888 – Section 5.8.3 The Transition Economies of Europe
(Integration of former command economies with the EU.)

Outline of content

Analysis of the reasons will focus on the causes and consequences of:

- low labour costs;
- low unit labour costs;
- low taxation;
- economic stability;
- membership of the EU.

Without explanation of cause and effect the reasons will be understood and applied in context but will not be analysed.

Commentary on the reasons could include one or more of the following (the list is not meant to be exhaustive and candidates may opt to display depth in evaluation rather than breadth):

- the relative significance of each of the reasons for attracting greater FDI;
- how different reasons may apply to different industries/sectors of the economy;
- the extent to which the reasons for location of FDI in Slovakia may be eroded over time;
- the extent to which the reasons may become less important with the entry of new members of the EU;
- the extent to which low labour costs are more or less important than labour productivity in determining unit labour costs – is it cheap labour that attracts FDI or skilled labour;
- the nature of the FDI itself relative to the reasons.

- Level 4** For a commentary on the reasons why Slovakia has attracted increased foreign direct investment since it joined the EU in 2004. [10-15 marks]
Band 2 – in this Band commentary will be developed beyond simple points or statements and include explanation, justification and judgement. [13-15 marks]
Band 1 – points of evaluation only (i.e. statements with no development or justification) [10-12 marks]
- Level 3** For an analysis of the reasons why Slovakia has attracted increased foreign direct investment since it joined the EU in 2004. [5-9 marks]
- Level 2** For an application and critical understanding of the reasons why Slovakia has attracted increased foreign direct investment since it joined the EU in 2004. [3-4 marks]
- Level 1** For knowledge and understanding of FDI only. [1-2 marks]

- 4 Discuss the likely benefits for the Slovakian economy of membership of the euro area. [20]

Synoptic knowledge

Module 2888 – Section 5.8.2 Economic and Monetary Union (EMU)

(The benefits and costs of European monetary union. The microeconomic pros and cons of the euro. The macroeconomic pros and cons of the euro. The performance of the eurozone economy, including the performance of national economies within the eurozone)

Outline of content

The benefits of membership of the euro area include:

- **elimination of transaction costs** – membership eliminates the costs of exchanging currencies in trade with the rest of the euro area. These are on-going benefits in the long run and reduce the costs of trade, reducing prices, reducing the scope for price discrimination.
- **reduced exchange rate uncertainty** – the exchange rate risk in trade with other members of the euro area is eliminated. Lower real rates of interest are likely. This is likely to lead to greater consumption and investment and therefore economic growth as it creates certainty in trade. Again, this is an on-going benefit.
- **greater price transparency** – prices in a single currency are more easily comparable leading to greater competition and trade amongst members of the euro area. This promotes economic growth and employment - the benefit is on-going.

There are costs of membership of the euro area, including:

- **loss of monetary policy sovereignty** – the ability to determine interest rates to suit the individual circumstances of the economy may lead to problems (for some this may be high inflation, for others low growth).
- **restriction on the use fiscal policy** – the Stability and Growth Pact constricts an economy's ability to use deficit financing to cushion the impact of recession.
- **lack of real convergence** – an extension of the above two points.
- **price increases** – conversion to the euro may result in one-off hikes in prices as firms take advantage of the uncertainty created in the switch from one currency to another.

Analysis of the benefits requires more than just explanation of each benefit. There should be an attempt to explain how they will impact on economic growth, inflation and unemployment.

Discussion of the likely benefits clearly requires a recognition that there may be costs of membership as well as benefits. Higher level evaluation will focus on the extent of the benefits or costs or distinguish between the short run and long run. For example, the extent of the benefits and costs depends on the degree of real convergence and integration with the euro area.

- Level 4** For a discussion of the likely benefits for the Slovakian economy of membership of the euro area. [12-20 marks]
- Band 2 – in this Band discussion will focus on the extent of the benefits RELATIVE to the costs, distinguish between short and long run effects or develop evaluation of the benefits by considering the nature and importance of real convergence. In short, the evaluation will be developed beyond simple points or statements and include explanation, justification and judgement. [17-20 marks]
- Band 1 – answers in this Band will consider the benefits and costs of membership of the euro only. [12-16 marks]
- Level 3** For an analysis of either the benefits of membership of the euro area or the costs but not both. [5-11 marks]
- Level 2** For an application and critical understanding of the benefits and/or costs of membership of the euro area, but without underpinning economic analysis. It is important that responses containing some economic analysis are not placed in this Level. [3-4 marks]
- Level 1** For knowledge and understanding of the euro area only or of the nominal convergence criteria referred to in Extract 5. [1-2 marks]

Specification Grid

AO	Question 1		Question 2	Question 3	Question 4	TOTAL
	(a)	(b)				
AO1	3	3	2	2	2	12
AO2	3	3	2	2	2	12
AO3		3	3	5	7	18
AO4			3	6	9	18
TOTAL	6	9	10	15	20	60

Grade Thresholds

Advanced GCE Economics (3812/7812))
January 2010 Examination Series

Unit Threshold Marks

Unit		Maximum Mark	A	B	C	D	E	U
2884	Raw	45	32	29	26	23	21	0
	UMS	90	72	63	54	45	36	0
2885	Raw	45	33	30	27	24	22	0
	UMS	90	72	63	54	45	36	0
2886	Raw	45	32	29	26	24	22	0
	UMS	90	72	63	54	45	36	0
2887	Raw	45	29	26	23	20	18	0
	UMS	90	72	63	54	45	36	0
2888	Raw	60	42	37	32	27	22	0
	UMS	120	96	84	72	60	48	0

Specification Aggregation Results

Overall threshold marks in UMS (i.e. after conversion of raw marks to uniform marks)

	Maximum Mark	A	B	C	D	E	U
3812	300	240	210	180	150	120	0
7812	600	480	420	360	300	240	0

The cumulative percentage of candidates awarded each grade was as follows:

	A	B	C	D	E	U	Total Number of Candidates
3812	27.27	45.46	90.91	100.00	100.00	100.00	15
7812	15.36	58.80	84.64	97.38	99.63	100.00	281

296 candidates aggregated this series

For a description of how UMS marks are calculated see:

http://www.ocr.org.uk/learners/ums_results.html

Statistics are correct at the time of publication.

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

14 – 19 Qualifications (General)

Telephone: 01223 553998

Facsimile: 01223 552627

Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

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