THE SCOTTISH ECONOMY

Summary of Current Business Trends

The first quarter of 1976 has seen a slowing down in the rate of increase of unemployment, of prices, and of unit costs, the flattening out of output and healthier order books. The principal factors in bringing about this relative improvement have been a reduced rate of de-stocking and a better export performance. These generalisations, however, conceal wide disparities of experience among sectors. The greater variation in the state of business expectations and confidence which we anticipated in our last Commentary was confirmed by the latest CBI Industrial Trends survey.

For a number of industries, both domestic and export, order books showed a distinct improvement in the last quarter of 1975. Figures 1 and 2 show the percentage of respondents to the CBI Survey in Scotland and in the UK respectively reporting an increase in their new orders. Figure 1 shows that the total order book has improved from the trough in the second and third quarters of that year. If we disregard the 1975/3

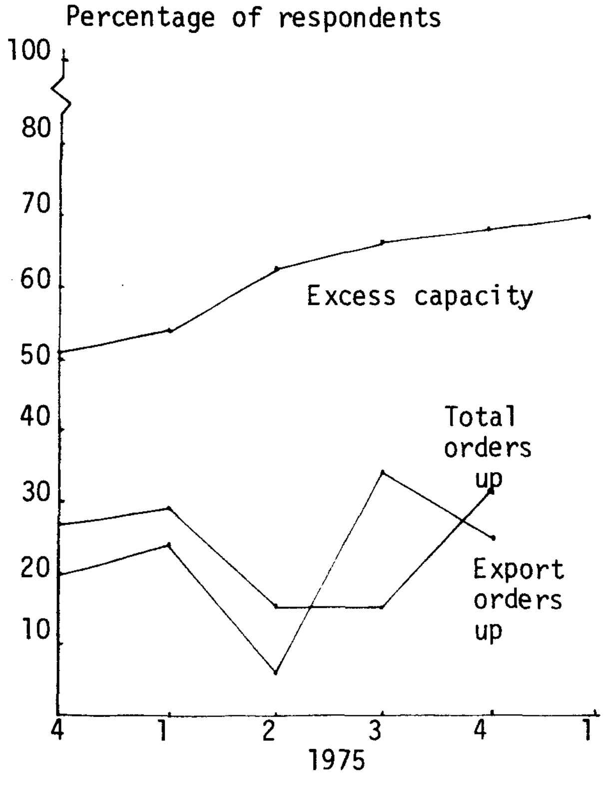


Figure 1 Scotland

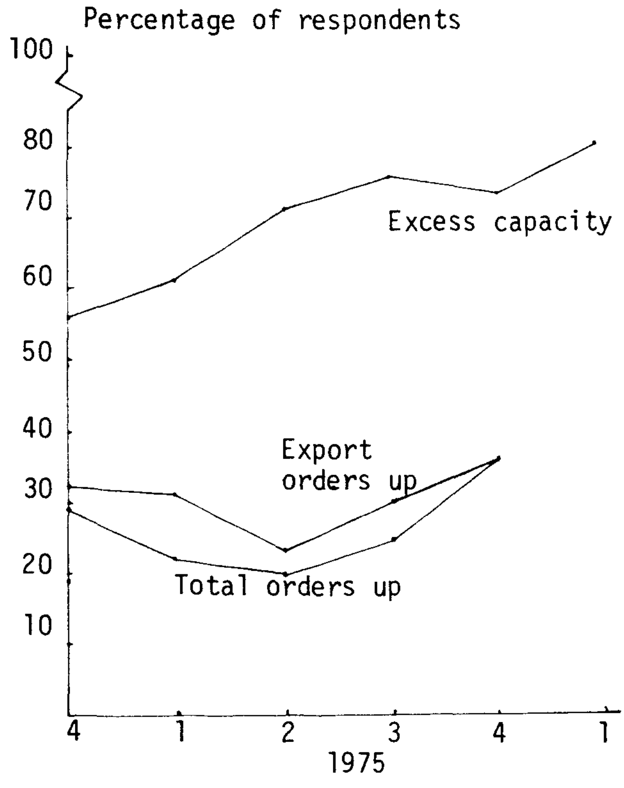


Figure 2 UK

Source: CBI Industrial Trends

response, then export orders can be seen to have followed a similar pattern. Comparison of Figure 1 with Figure 2 shows that in each of the last five quarters a larger number of UK firms have reported an increase in export orders than in total orders, whereas for Scotland that position is reversed. This may be accounted for by the heavy weight which shipbuilding is thought to have in the Scottish export survey. So far as the most recent quarter is concerned it is clear that while capacity utilisation is at a higher level in Scotland than in the UK, Scotland's new order position is slightly less favourable.

In the chemical and textile sectors there are signs of progress with improved order books and higher rates of capacity utilisation. Light engineering, which we predicted in our last issue of the Commentary to be the most buoyant sector during the present recession, has also made substantial gains in export orders, and is operating at a high level of capacity.

Consumer goods industries have been showing signs of increased activity, and they will have received a further boost from the recent reduction in VAT rates on electrical appliances and other durable goods announced in the Budget.

Prospects in some of the producer goods industries are less certain, indicating a rate of recovery very much dependent on how quickly the leading industries pick up. The CBI Survey suggests that the mechanical engineering sector is unlikely to contribute to an early recovery; on the other hand, some firms in this sector have recently won major overseas orders.

There are some industries which are still in the grip of the current recession. Firms in the food processing sector have been given little encouragement by the effects of the continuing depreciation of the pound together with the recent EEC farm price review on unit raw material costs. The whisky industry, already facing a depressed home market, has been burdened with a major increase in taxation for the second year in succession. This can only have the effect of depressing sales and employment still further. Much more serious, though less easy to quantify, is the regressive effect of this tax on the distribution of real income.

Although the turnover of the building materials sector increased moderately in the last quarter of 1975, the CBI Survey indicated considerable excess capacity with little sign of increasing order books.

The value of new orders obtained by contractors in the construction industry was maintained throughout 1975, while the effects of local authority spending restrictions may not have a substantial effect upon the industry's output until 1977.

The coal industry experienced a bad year in 1975, with falling output, productivity and employment. This suggests, as our special article in this issue argues, that the benefits which the industry might have been expected to enjoy from the 1973 oil price increase have already evaporated. The oil industry, as we note below, is moving from the period of exploration to production, and the recent discovery of two substantial new fields have added considerably to the industry's confidence in the future. During 1976 the value of oil produced from the North Sea will be in the region of £100 million, which will make it already Scotland's third largest industry in terms of value of output, behind agriculture and whisky.

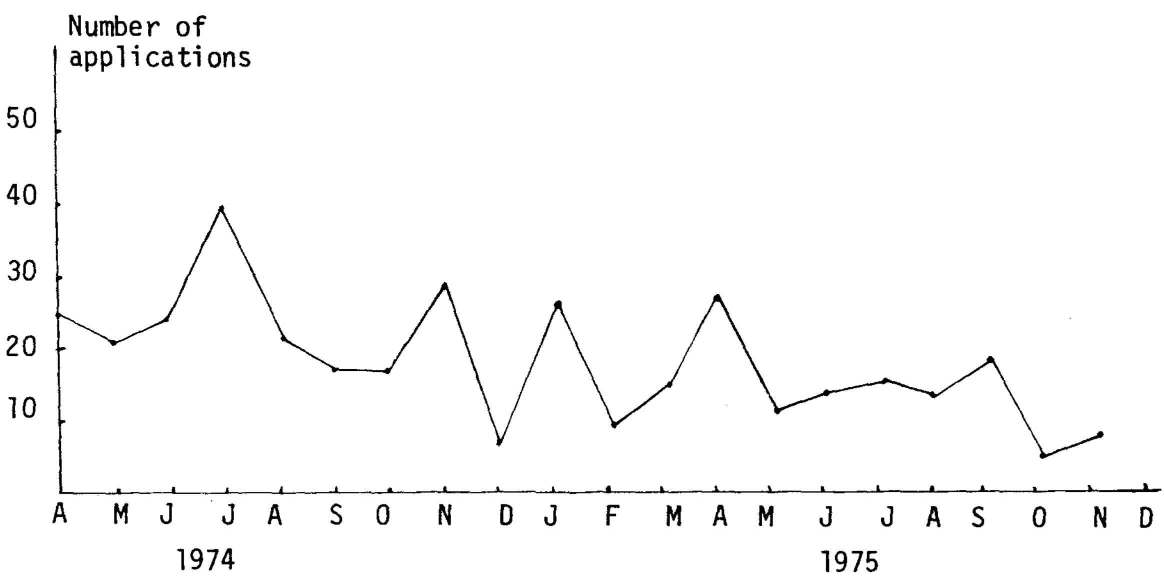
In agriculture, improved profitability during 1975 together with an element of greater price certainty lead some observers to expect a good year for the industry, with a significant improvement in capital expenditure. However, there seem to be well-founded fears that the proposed changes in taxation and tenure arrangements may threaten the future of the working farmer.

The telecommunications sector expects to expand its output in 1976 more rapidly in Scotland than in the UK as a whole. The electricity supply industry is also expecting an improved volume of sales towards the end of the year.

There is unfortunately another category of industry in Scotland: those where problems cannot be expected to be solved by the ending of the recession. In this category must be included motor vehicles, shipbuilding and steel. The problems of these industries are sufficiently well documented and need not be repeated here. Despite the losses of employment, a substantial increase in the level of steel production is expected in Scotland in 1976, while metal manufacturing order books improved in the last quarter. All the larger shipbuilding yards of Scotland are due to be nationalised in October of this year. Experience of nationalisation so far offers no evidence to support the belief that such a transfer of ownership will by itself restore the industry to health.

A new series of quarterly estimates issued by the Department of Industry suggests that manufacturing investment in Scotland did not fall, as it did in the UK, between the fourth quarter of 1974 and the second quarter of 1975. For more up-to-date information on investment we have so far no better indicator than the number of applications for regional selective assistance. Figure 3 shows that this series has moved downwards in the last twelve months.

Figure 3 Regional Selective Assistance



Source: Trade & Industry

There are a number of pieces of evidence which point to the conclusion that the Scottish economy was doing less well in the first quarter of 1976 than it was in the same quarter of 1975. Amongst these is the number of bankruptcies of firms registered in Scotland (see Figure 8). But the deterioration is no more than for the UK as a whole, which gives some reason to hope that when the upswing does begin, Scotland will not lag behind.

Excess Capacity as an Indicator of Aggregate Demand

Indirect evidence from the labour market is commonly used to provide quantitative indication of shifts in the level of aggregate demand. However, labour market indicators have a number of well-known deficiencies, such as the 'labour hoarding' problem, when used to measure shifts in demand. An alternative indicator which has received little attention, at least in the Scottish context, is the CBI index of capacity utilisation even though it has been argued* that this index is superior to most others in conventional use. The index is formed from the results of a questionnaire sent out by the CBI each quarter to a sample of firms. The firms are asked whether or not they are operating at capacity. Figure 9 plots the proportion of Scottish firms who claimed to be operating at less than full capacity over the period 1967 - 1st quarter 1976. Quarterly unemployment figures are also presented in the diagram. There is an obvious close correlation between the two series, though in 1968 and 1969, perhaps as a result of the rise in overtime working which occurred at that time, the unemployment figures failed to pick up an increase in demand which certainly occurred at a UK level and probably also in Scotland.

There is no quantitative evidence as yet to suggest that movements in the CBI index lead similar changes in the level of unemployment though one might expect this to be the case since there is a definite lag in the transmission of the shifts in the product market to shifts in the labour market. Both series reached a nadir in the first quarter of 1972 indicating the very low level of demand at that time while in 1973, when demand was much higher, the CBI index peaked three months before unemployment. During the current recession both series have fallen sharply though over the last two quarters the fall in the CBI index has been less dramatic than the rise in unemployment. If it is the case that the capacity index leads unemployment this would indicate a slowing down in the increase of unemployment over the next few months.

* J Taylor and S McKendrick "How should we measure the pressure of demand?" Lloyds Bank Review, January 1975

Unemployment and Vacancies

In the January issue of the Commentary a table of the ratio of unemployment (U) to vacancies (V) in each of the standard regions of the United Kingdom in December 1975 was presented. The U/V ratio is often used as an approximate measure of pressure in the labour market. For example, when unemployment is high and vacancies low the U/V ratio will be high, indicating a slack labour market. However, should the efficiency of labour markets in allocating workers differ between regions the pattern of U/V ratios may give a misleading view of relative pressure in different labour markets.

Professor D MacKay, commenting on the table of U/V ratios in our last issue has argued (Scotsman, Wednesday 7 April 1976) that the relatively low U/V ratio in Scotland is more indicative of the inefficiency of the Scottish labour market than of a genuinely tight labour market. Certainly Scotland's relatively high rate of unemployment lends support to this view. Professor MacKay goes on to argue that this inefficiency is caused by the low level of labour mobility which results from the preponderence of subsidised council housing in Scotland. Although census evidence on interregional migration in Scotland certainly suggests that geographical mobility is low among council house tenants, one can argue that occupational immobility is an equally important barrier to the efficient operation of the Scottish labour market.

Table (VII) presents unemployment and vacancies statistics for the standard regions of the UK, the Strathclyde Region and for the rest of Scotland. The rate of unemployment in Strathclyde at 7.7% is higher than that of any standard region of the UK, yet there are more vacancies in Strathclyde than in the West Midlands, a region whose population is approximately twice as large. Consequently, the U/V ratio in Strathclyde at 10.4 is lower than one might expect given its high level of unemployment. This suggests that the labour market within the Strathclyde region is inefficient in allocating workers to job opportunities. Although geographical immobility may to some extent cause frictions in the market to develop, the transport system is sufficiently well developed and the population centres sufficiently concentrated to suggest that occupational immobility is a major obstacle to the reduction of unemployment in Strathclyde.

Regional Unemployment Changes

Between December 1975 and March 1976 unemployment in Scotland rose by 14.1 thousand (see Table VI) from 131.0 to 145.1 thousand. The Strathclyde region, where unemployment rose from 74.6 thousand to 83.4 thousand, accounted for 62% of this increase. However in percentage terms the increases in unemployment in the larger regions have been remarkably similar. The rise in unemployment in Strathclyde was 12%, identical to the rises in Central and Lothian regions. In Tayside and Fife the increase was slightly lower at 10% while in the Grampian region there was a 15% increase in unemployment between December 1975 and March 1976. In the October Commentary we noted a remarkable consistency in percentage increases in unemployment among the regions and argued that this indicated that the recession was affecting the regions in a largely uniform manner. Though this consistency appeared to be much weaker between September and December 1975, the above would suggest that it had reasserted itself between December and March. Thus it would appear that, at least in the larger Scottish regions, the recession is once again being felt with equal force. The level of unemployment in several broad geographical areas (amalgams of the local authority regions) in Scotland is presented in Figure (10).

Male/Female Comparisons

In the October Commentary we argued that female unemployment had risen more sharply than male unemployment during the first three quarters of 1975,principally because of the predominantly male employment created by North Sea oil. The proportion of females amongst the unemployed increased only marginally from 25% to 26% during the last two quarters, suggesting that males and females are now being 'shaken out' at almost identical rates. However, unemployed females in Scotland constitute a largerproportion of total female unemployment in Great Britain than do unemployed Scottish males of GB male unemployment. In February 1976 Scotland accounted for 12.7% of female unemployment in Great Britain, but only 11.1% of male unemployment.

Measures to Alleviate Unemployment

In August 1975 the Temporary Employment Subsidy Scheme was introduced in assisted areas in order to reduce the increase in the rate of unemployment. The scheme offered employers about to dismiss at least 50 workers a subsidy of £10 per week for each worker for three months with a possibility of a further three months extension. Since August the scheme has been extended to all areas in Great Britain, the number of workers reduced from 50 to 25 and the subsidy was increased to £20 by the Chancellor in his Budget speech.

Although this measure may temporarily relieve the unemployment position, the effect of subsidising firms who are either inefficient or operating in markets where demand is contracting will be to leave industry less competitive and employment prospects less secure when the upswing does come. Perhaps the £124 million which the scheme is expected to cost could be more effectively spent on further schemes to improve the operation of the labour market and so ensure a viable recovery. Already, retraining schemes and relocation grants are available to workers. One could further increase the incentive to take up new employment by extending these schemes. Another possible way to improve the operation of the labour market and so ameliorate the unemployment situation is to reduce the 'cost' to the worker of searching for a new job. Finding a job can be expensive in terms of both money and time. Any measures which improve the dissemination of information, such as a higher level of notification of vacancies to employment offices, may be instrumental in reducing friction in the market.

In September a scheme to provide jobs, particularly for young people in areas of high unemployment, was instituted by the government. Grants to groups wishing to participate were to cover wages, national insurance contributions and an amount of up to 10% of labour costs for materials, equipment or administrative costs. The Job Creation Programme in Scotland was initially given £8million and this was increased by a further £8 million in March. So far only £4.33 of this allocation has been taken up. In fact 4626 jobs have been created and 2858 of these are in projects which have already started. The vast majority of the schemes so far approved are sponsored by local authorities and most are concerned with environmental regeneration. Private companies have been very reluctant to sponsor schemes ,principally because the allowance for materials, administration etc. is such a small proportion of labour costs. One result of the low allowances is that the schemes forwarded will provide little in the way of training for those engaged in them. Given the low 'take up' of the £16 million grant there is a strong case for increasing the materials allowance and so increasing the training element in the schemes.

One group who are unlikely to benefit from either of the above measures are long term unemployed males. In January,1976 20,789 males had been unemployed for over 52 weeks in Scotland; 14,149 of these were aged over 40; 18.7% of unemployed males in Scotland had been unemployed for more than a year. In Great Britain the comparative figure was markedly lower at 16.7%. Again retraining might be a means of increasing the attachment of this group to the labour market - an attachment which will have become increasingly tenuous as the period of unemployment increased.

Scotland vis-a-vis Great Britain

The unemployment relative (Scottish unemployment seasonally adjusted/ Great Britain unemployment seasonally adjusted) marginally increased from 11.4% in December 1975to 11.5% in March 1976. The sharp decline which occurred during 1974 and 1975 appears, at least temporarily, to have stopped. Indeed,should previous experience of Scotland's recovery lagging behind that of the UK be repeated one might expect this relative to increase from now on.

An examination of the numbers of employees in employment provides further information on Scotland's comparative economic performance. In June 1972 Scotland accounted for 9.19% of all employees in Great Britain (see Table (VIII)). By September 1975 it is estimated that this proportion had risen to 9.31%; although there was a net loss of 3000 jobs in manufacturing, Scotland's share of employment in manufacturing rose from 8.45% to 8.73% . However, this improvement has not occurred at a uniform rate over the period. Between June 72 and June 74,when there was a sharp increase in demand in the country as a whole, employment rose more quickly in Scotland than it did in Great Britain. Possibly this was a result of the added effect of North Sea Oil in the Scottish economy. In June 1974 the total employment relative had risen to 9.35% and the manufacturing employment relative to 9.31%. Since then both relatives have drifted down slightly. Between June 1974 and September 1975 total employment fell by 23,000. An estimated fall of 36,000 in manufacturing industry, coupled with a net loss of 6,000 in other index of production industries and 2,000 in agriculture, forestry and fishing, was offset to some extent by a substantial rise in the service sector. A rise of 15,000 in public administration and defence accounted for approximately 75% of this rise in employment in service industries. The stringent controls which have been imposed on local authorities in the wake of regionalisation and an excessive public sector deficit are likely to ensure that growth in employment in this sector will be sharply reduced in the future, unless there is a substantial movement of central government employment to Scotland.

Concurrent with the rise in employment between 1972 and 1974 was a substantial fall in net migration from Scotland. Between June 1973 and June 1974 net migration, at 2,000, was the lowest on record. As employment contracted between June 1974 and June 1975, migration rose to 19,000. The improvement in Scotland's relatives vis-a-vis the rest of Great Britain has coincided with a substantial increase in the proportion of migrants going overseas rather than moving to the rest of Great Britain.

Outlook for 1976

In previous recessions, it has been widely believed that Scotland suffered greater losses of output and employment than did the UK as a whole, and that her recovery took place later. This experience was explained by the equally general belief that Scotland had a preponderance of "heavy industries" (i.e. capital goods industries) which were presumed to suffer more severely during recessions. An examination of the Census of Production shows that, in fact, Scotland has a *less* than proportionate share of the output of every sector of heavy industry in the United Kingdom, with the exception of shipbuilding and marine engineering, and agricultural machinery other than tractors.

Whether for this reason, because of oil, or for some other reason, the indications are that the Scottish economy is so far in this recession not performing as badly as might have been expected from previous experience.

First of all, an analysis of bank advances by R G Baird of the Royal Bank suggests that while the demand for borrowing from industry fell away in mid-1974 in England, the Scottish banks' advances did not decline until almost a year later, in mid-1975. This implication of a much later downturn in economic activity in Scotland is supported by the statistics of manufacturing investment.

Secondly, there is the question of the relative depth of the recession in Scotland and in the UK. Until the Government's new index of industrial production is published, we shall not have a conclusive answer to this question, but the fragmentary evidence which is available suggests that the proportionate decline in output and eventually in employment in Scotland may not be worse, and may even be less, than in the UK as a whole.

Finally, there is the question of the timing of recovery. On the basis of previous experience one might expect an upturn in economic activity in Scotland to lag behind the UK by between six months and a year. On this occasion, it may be as well to examine the specific factors operating in Scotland to determine the rate of recovery. To begin with the foreseeable negative influences which are acting to dampen or postpone a recovery , these include the following:

(a) The slow rate of recovery of the English market, particularly for consumer goods. However, this could change if the Budget change in VAT rates on electrical appliances and other consumer durables should precipitate a rapid rise in consumer spending.

(b) The limitation on local authority current and capital expenditures.

(c) The losses suffered by exporters in the past, as a result of the rise in their unit costs due to domestic inflation rates exceeding, until recently, the fall in the pound.

(d) The movement of oil development from the exploration to the production stage. This will particularly hit fabrication and engineering activities in Strathclyde Region, but will benefit Grampian and Shetland.

(e) The uncertainty over worker acceptance of a further fall in real wages.

(f) The difficulties of particular industries, e.g. shipbuilding, vehicles and aircraft, which are not directly related to the recession but which tend to have a multiplier effect locally.

(g) The relative importance of the public sector in Scotland makes the Scottish economy particularly vulnerable to restrictions on UK central government expenditure.

A comparatively neutral role, in contrast to past recessions, is being taken by the construction industry. The total value of new orders obtained by contractors has held up well throughout 1975, as has housing starts. Thus construction activity during 1976 would appear to be fairly level; the effect of reductions in local authority capital spending is unlikely to make itself felt until 1977.

Among the positive influences leading to an early revival of economic activity in Scotland may be counted the following:

(a) As we noted above, a steady expansion may be expected in major world markets through 1976. The recent sharp fall in the sterling exchange rate should improve the cost competitiveness of exporters and allow them to take advantage of the continuing demand for producers' goods and services emanating particularly from the oil-exporting countries.

(b) The income-multiplier effects of oil production activities, although largely confined to Grampian Region, and Shetland, may be greater than earlier supposed.

(c) There is an historically high level of personal saving, which could be precipitated into increased consumer spending.

(d) Capital expenditure by manufacturers in Scotland was improving up to mid-1975. Thereafter, we have no firm evidence. But it may be noteworthy that while investment enquiries made to the Scottish Office from outwith Scotland fell by more than 50% between 1974 and 1975, enquiries from firms within Scotland rose by 34% over the same period.

This last statistic points to what may be the critical factor in determining the strength of the recovery, namely, the state of confidence amongst indigenous business firms in Scotland. The key question here is whether the growth in confidence which was detectable just before oil began to make its stimulating effects felt in 1973 may have survived the inflation-cum-recession of the last two years. If this is so, then the outlook for the medium-term as well as the short-term may be encouraging.

Appraisal

The fragmentary evidence which is available to us about the path of total output and employment in Scotland during the present recession is open to two alternative interpretations.

The first is that Scotland is following the traditional pattern of behaviour with respect to the UK economy. The downturn and upturn follow the UK cycle with a lag of between six months and a year, while the trough of the recession is deeper. Thus, the observation that Scotland has so far fared less badly in some respects than the UK may only mean that output in Scotland has not yet reached its nadir, while in the rest of the UK it apparently has. The implication of this explanation is that one should not look for a marked recovery in output until perhaps the end of the year, with no prospect of a downturn in unemployment until well into the Spring of 1977.

The other, more optimistic, interpretation is that, whether because of a change in the composition of industries, because of oil, or some other reason, the traditional pattern has been broken, and that total output will fall proportionately less in Scotland than in the UK and will turn up at about the same time. This would imply a levelling off of unemployment in the autumn.

We incline to the latter view, although we should emphasise that optimism should be tinged with caution: it is too soon to speak with confidence of a marked recovery within the next six months. Any early recovery is likely to be a slow one.

In October we forecast that the unadjusted level of unemployment would rise to 145,000 by March. In January, as a result of the massive 31,000 increase between December and January, we revised our March forecast upwards to 150,000. The actual level of 145,100 was much closer to our earlier forecast.

Since March 1975 seasonally adjusted unemployment, excluding school leavers and students, has risen from 90,800 to 135,500 - a monthly increase of just over 4,000. If this rate of increase were maintained, seasonally adjusted unemployment would rise to 160,000 by October (implying an actual figure somewhat above 165,000). However, we take the view that the rate of increase will be moderated in the next few months and,even though actual unemployment is likely to rise above 160,000 with the next influx of school leavers onto the labour market, by October the seasonally adjusted unemployment figure will be around 153,000 (implying an actual figure around 158,000).

In the United Kingdom in the post-war period the attention of economists and the public has been concentrated on the periodic cycles of aggregate demand, output and employment. But we should not forget that at the same time as these fluctuations are going on, changes are taking place in the industrial, regional, and social composition of these aggregates which are ultimately more important in the long run from the point of view of security of employment and the level of real wages.

In the course of this review of the present state of the Scottish economy, we have touched on some of these changes. The current performance and future prospects of some industries contrast markedly with others, as do the performance and prospects of the different regions within Scotland. The shift in the composition of employment from manufacturing to services may reflect a changing social composition of the employed and the unemployed. In future issues of the Commentary, we hope to discuss these questions at greater length. In the July issue of the Commentary, we shall take our annual look at GDP and forecast its movement over the next twelve months.