OUTLOOK AND APPRAISAL

Since the publication of the April Quarterly Economic Commentary, two events have occurred which are likely to have a substantial effect on the Scottish economy in the next few years. Firstly, the OPEC countries have agreed on a rise to between $19 and $23.5 in the price of a barrel of oil. As indicated in the World section, given inelastic demand, the effect of this is to transfer real income from the oil importing countries to the oil exporters. This need not depress world trade if some effective mechanism for recycling the foreign currency which the oil exporters will accrue can be found. Complete success is unlikely and so, as suggested earlier, world trade will be reduced by about 1% as a result of the price rise. The Scottish economy relies heavily on trade with the outside world, and therefore must expect some reduction in the demand for Scottish goods from oil importers, though this may be partially compensated by increased exports to OPEC countries.

The position of Scotland and the UK with respect to oil supplies is, of course, somewhat different from most of the other industrialied Western nations, (see UK section) since the UK can now meet most of its oil demands from the North Sea. In anticipation of the ability of the UK economy to maintain a current account surplus on the balance of payments because of its plentiful domestic oil supplies, foreign exchange dealers have bought heavily into sterling, thus pushing up the exchange rate, particularly with respect to the dollar. The rise in the exchange rate, by making imports cheaper, has the effect of increasing real incomes. Thus, real incomes in the UK have risen because of its possession of a particular asset and not because of increased output by industry. Indeed, this rise in the exchange rate, as mentioned in both the Leading Indicators and Industrial Performance sections is making it difficult for Scottish industry to price competitively in export markets. These difficulties are compounded by domestic inflationary pressures, both from the increased price of energy and from wage increases which are still above those of our major competitors. Thus there is, at present, a two-way squeeze on profitability in the UK. In the long-run, it is argued, wage pressure will decline as workers come to appreciate that a rising exchange rate increases their real incomes and also that unemployment is the inevitable result of continuing reductions in profitability. However, there is little indication that such an appreciation is imminent and indeed such a position, at least in respect of the rise in the price of oil, is quite logical. Workers have benefited from the increased oil price only insofar as it has increased the exchange rate. The increase in the price of oil has been fully passed on to them, so attenuating any increase in real income. In the short-run it is the government which particularly stands to gain from the price rise, through increased oil revenues. These may, in future, be passed on to the consumer in tax reductions, but are unlikely to effect bargaining during the current wage round. If wage settlements continue at the same rate as those of 1978 and the first part of 1979, it is inevitable that there will be increased bankruptcies and unemployment. Waiting for the long-term adjustment of the exchange and wage rates may prove an onerous burden.

The lack of immediate realisation on the part of the UK consumer of the beneficial effects of an increase in the price of oil - an effect which is immediately accommodated or even anticipated by the exchange markets - increases the attractiveness of the scheme recently proposed by Sam Brittan in the Financial Times. Rather than allow government to accumulate vast revenues this would give each consumer a direct share in the North Sea which could be bought or sold and whose value would fluctuate in line with the oil price.

The second major change over the last three months which will have important implications for the Scottish economy has been the election of a new government. Already it has made clear its main tenets of policy. It favours tight monetary control and was prepared to lift the mimimum lending rate to 14% in order to contain the expansion of the money supply eyen though this made sterling even more attractive to foreign investors and increased the upward pressure on the exchange rate. With respect to fiscal policy it generally favours reduction in taxation, but is prepared to substitute indirect for direct taxes. This latter point was ampply demonstrated in the June budget where minimum rates of VAT were inceased from 8% to 15% and the standard rate of income tax reduced from 33%to 30%. It is also clear that the new government is intent on cutting public expenditure. This is being approached in a number of ways. Particular measures which will affect Scotland are:

(1) a cut of £35 million in rate support grant tɔ Scottish local authorities during the current year (part of an overall cut of £76 million in Scottish Office spending).

(2) reductions in regional incestment aid brought about by

  (a) deferral in payments of regional development grants (which is expected to save £145 million in the UK during 1979/80)

  (b) reduction in area within which development grants are payable

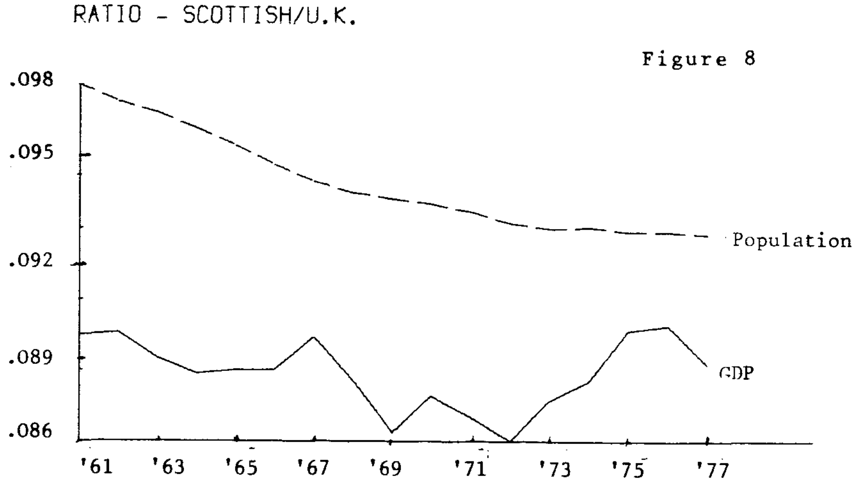
  The changes in regional development grant status for large parts of Scotland are indicative of a change to more selective aid for industry which was predicted in our last Commentary.

(3) curtailment of training and employment programmes (expected to save £200 million in the UK during 1979/80)

Some other minor cuts have been made, which, though trivial in size,will make it difficult to interpret the behaviour of the Scottish economy. For instance, for the first time since it was instituted in 1971, there will be no Census of Employment in 1979. This Census, widely used by local authorities, independent researchers and others, provides the most detailed indication of the structure of the economy, even for quite small areas. Further, the new administration has abandoned plans to compare the price level in Scotland with that in the rest of the UK. Thus the UK will remain one of the few Western nations to have virtually no information on price variation within the country, even though the absence of such information means that regional statistics collected in nominal terms are invariably subject to substantial qualification before any real comparisons can be made.

The main problem, however, is the likely reaction of the Scottish economy to the major cuts mentioned earlier. In one of the special articles included in this Commentary, David Bell and Frank Kirwan suggest that, over the next five years, labour supply in Scotland will rise by some 57,000. Further, their predictions of the demand for labour show a fall of 63,000, based on a fall in manufacturing output resulting from cuts in aggregate demand through reductions in exports and public expenditure and increases in imports. On the face of it, this would imply a 120,000 increase in unemployment over the next few years, though not all of these will necessarily join the unemployment register. There is no reason to suppose that Scotland can take advantage of special circumstances, as it was able to do in the late sixties and early seventies, and grow at a rate sufficient to avert this increase. Indeed, the evidence that the Scottish economy has been performing less well than that of the UK as a whole over the last four years is beginning to accumulate. Recent estimates put Scotland's nominal GDP in 1977 at £10,827 million.

Figure 8 which plots Scottish population as a proportion of UK population (declining because of Scotland's high net emigration) and Scottish GDP as a



Source: *Annual Abstract of Statistics*
Economic Trends

proportion of UK GDP, illustrates the fluctuating fortunes of the Scottish economy. After a steady increase during the period 1972-1976, when GDP per head in Scotland came within 4% of that in the UK as a whole, Scottish GDP declined to 8.86% of UK GDP in 1977.

Another disturbing symptom of the decline is the relatively poor performance of Scottish manufacturing output over the period 1975-1978 (see Leading Indicators Figure 3), and in particular the decline of mechanical engineering (see Industrial Performance). There is reason to believe therefore, that the economy has been drifting backwards relative to the UK recently. The short-run effects of the spatial redistribution of demand resulting from the public expenditure cuts and tax changes will be to deflate the Scottish economy. Because the changes are likely to have a more severe effect in the development areas, the relative decline in the Scottish economy is likely to continue.

In our last Commentary we predicted a seasonally adjusted level of unemployment in Scotland in June of 166,000. The outturn was 164,500. While there will be an inevitable rise in total unemployment in July due to the influx of school leavers into the labour market, it is likely that the seasonally adjusted level of unemployment will continue to drift downward to around 162,000 in October. Thereafter, the effects of changes in policy and the rise in the price of oil will begin to filter through to the labour market and we would therefore expect seasonally adjusted unemployment to rise to 173,000 in December.