SCOTLAND IN THE UK ECONOMY*

by Keith P D Ingham and J Love

Scotland is closely integrated with the rest of the UK (RUK). Membership of the UK economic and monetary union means that there are no restrictions on the movements of capital and labour between Scotland and RUK; there are no tariffs on goods traded with RUK; and there is a common currency. There is no economic strategy for Scotland separate from that for the UK, although UK regional policy is aimed at tackling the sorts of problems Scotland shares with some other UK regions. Scotland has an advantage over other UK regions, however, in that the Secretary of State for Scotland represents Scotland's interests directly in Cabinet. In addition, there are, as well as the Scottish Office in Edinburgh which is responsible for much of Scotland's share of central-government spending, specifically Scottish agencies such as the Scottish Development Agency (SDA) and the Highlands and Islands Development Board (HIDB).

The close ties with RUK dominate the Scottish economy in many ways; for example, large British firms, the nationalized and publicly owned industries and the UK civil service are among the largest employers in Scotland and the bulk of Scottish trade is with RUK. How does Scotland fare compared with other regions of the UK? How can we account for Scotland's relative performance as a region of the UK? What type of adjustment takes place in response to problems faced by Scotland? During the 1960s and 1970s there was a revival of nationalism in Scotland. While it was also based on historical, social and cultural issues, that revival, which has now largely abated, concentrated a great deal of attention on these questions.

Scotland's well-being in the UK Union

At the beginning of the twentieth century Scotland was one of the more thriving areas of the UK. Shipbuilding and the iron, steel and coal industries created considerable prosperity. Glasgow flourished as a major city in the British Empire. This prosperity disappeared, however, in the depression of the 1920s and 1930s. Since then Scotland has been considered one of the regions of the UK with structural economic problems, experiencing, like RUK, the impact of cyclical changes in output and employment but typically having a higher than average rate of unemployment and a lower average income.

---

* The Students Briefs in this issue of the **Commentary** are reproduced from "**Understanding the Scottish Economy**", edited by Keith Ingham and James Love, and published by Martin Robertson. The extensive cross-referencing which characterises the book has been deleted from the chapters produced here. For further details see p.64 below.

Scotland entered the 1970's as a relatively depressed region of the UK. Income per head was below the UK average and of the ten other UK regions exceeded only the levels for Wales, the North and Northern Ireland, a region with its own particular political problems. (See Table 1). Unemployment in 1971 was also considerably above the UK average and was only less than that for Northern Ireland.

TABLE 1 INCOME PER HEAD AND UNEMPLOYMENT IN UK REGIONS RELATIVE TO UK AS A WHOLE, 1971-80

	GDP per head at factor cost				*Unemployment (at July)*			
	1971	1974	1977	1980	1971	1974	1977	1980
North	87	92	96	93	163	172	132	147
Yorkshire and Humberside	93	95	96	93	112	99	93	104
East Midlands	97	96	97	97	85	84	81	86
East Anglia	94	92	95	94	91	76	87	78
South East	114	113	112	115	59	60	76	65
South West	95	93	92	95	95	102	111	91
West Midlands	103	101	97	95	85	79	93	103
North West	96	97	97	95	113	129	118	126
Scotland	93	95	96	96	170	153	130	136
Wales	88	87	90	87	128	139	127	138
Northern Ireland	74	74	75	75	221	217	174	182
UK	100	100	100	100	100	100	100	100

During the 1970s the development of oil-related activities was important to the Scottish economy, particularly in the North-east around Aberdeen. These activities meant that Scotland's relative position as a UK region improved in terms of both income per head and unemployment. By 1980 Scotland came third in the regional "league table" for income per head behind the South-east and East Midlands. However, Scotland's income per head was still below the UK average. Although, as in other UK regions, there were substantial rises in unemployment in the 1970s, the unemployment position in Scotland was less severe by 1980 than in Wales, the North and Northern Ireland. Nevertheless, it was still over one-third higher than the UK average, and higher than that for seven other regions.

Scotland's relative performance as a UK region

The relatively poor performance of the Scottish economy may be analysed in terms of developments since the 1930s in Scotland's trade and payments with the rest of the world (ROW) and RUK. This approach permits us to identify certain factors contributing to the depression of output, employment and the general level of economic activity in Scotland.

Falling demand for Scottish exports. Scotland's production and exports to RUK and ROW tended to be heavily concentrated on a fairly narrow range of activities such as shipbuilding, heavy engineering, steel making and coal mining. Employment generated by these activities was located in certain areas. Although some shipbuilding and engineering took place in the East on Tayside and at or near the Forth, these industries were of much greater importance in West-central Scotland. Communities in parts of Ayrshire, Lanarkshire, West Fife and the Lothians depended almost entirely on coal mining. As a result of trade with the Indian subcontinent, the jute industry in Dundee employed considerable numbers.

Technological change, foreign competition and the development of substitutes, however, have caused these traditional activities to decline over a long period of time. This has been true not only for Scotland but also for the other parts of the UK including South Wales, Northern Ireland and the North-west and North-east of England. This decline has been only partially offset in Scotland by the emergence of firms in other activities such as typewriters, computers and electronics. These firms, many of them branch plants of American multinationals, have been attracted to Scotland, at least in part, by the inducements offered through UK regional policy. But certain of the government-promoted schemes have been relatively short lived. Attempts to establish a motor-car industry in Scotland, for example, failed, probably due in part to locational factors and in part to international competition from other European and Japanese producers. The Scotch whisky industry emerged in the post-war period as the major export carner but employs relatively few workers. On balance, the growth of other firms has not been sufficient to offset the impact on output, employment and exports of the decline in traditional activities.

Increasing Scottish demand for imports. Changes in the structure of the UK economy have resulted in much 'polarisation' of economic activity. The head office and plants of many large manufacturing companies have been located in the South-east and the Midlands, attracted by, for example, the services available, the well-developed social infrastructure and the large markets offered by major population centres. This has fed through into further expansion of the banking, insurance and advertising services available in the South-east. As far as financial services are concerned, however, Scotland may have fared better than other UK regions since a great deal of financial activity is located in Edinburgh. An important factor contributing to polarization has been the rapid expansion of civil service employment based mainly in London.

The growth of employment opportunities in both the public and private sectors particularly in the South-east has been thought to attract much highly-skilled labour out of other regions including Scotland. In terms of inter-regional trade Scotland, like other regions such as the North-east, South Wales and Northern Ireland, has increasingly imported goods and services from the more prosperous South-east. This increase in imports from RUK will have reinforced the general UK tendency to import more from ROW reflected in the penetration of UK markets by foreign suppliers.

Net export of capital. The structure of the UK capital market with a concentration of control in the South-east may have created a net export of private capital from Scotland. This may have been offset to some degree by the retention of control in some institutions in Scotland. But whether Scots are lending to London-based or Edinburgh-based institutions, those institutions will advance funds in response to considerations of relative profitability and creditworthiness. They may, therefore, have favoured firms in more prosperous regions with a resulting net export of capital.

Scotland and the adjustment process

Markets are often thought to adjust to changes in demand and supply conditions through spontaneous changes in prices. A decline in demand, for example, for the output of Scottish firms might be expected to lead to reductions in both product prices and the prices of factor inputs including labour. Reductions in factor prices may lead to further falls in product prices. Through such adjustments firms may be able to regain some part of lost market shares. Any decline in output may free resources for use in other firms and industries which themselves could benefit from cost reductions.

Prices, however, are rarely that flexible among regions. Wages, for example, frequently a major component of costs, tend to be rigid as a result of wage bargaining between employers' organizations and trade unions at a national level. Refusal to permit a fall in workers' relative earnings is typically a central feature of unions' claims. In addition, many Scottish manufacturing plants are branches of large multiregional firms. These plants are likely to be part of a corporate structure with an overall development plan in which they have a specific and well-defined role. A company producing a given product in plants in different regions will generally sell all the output at the same price. A plant's relative cost advantage will show up as an addition to the company's short-term profits and may then lead to an expansion in the plant's planned capacity and output. If production is mobile, the region's problems of adjustment will be eased. However, switching production among regions may lead to problems with trade unions. Moreover, within the company's structure the Scottish plant may be producing intermediate products and the lower those products' shares in total cost, the more price inelastic will be the demand for the plant's output.

Where spontaneous price and cost changes do not take place or are insufficient to maintain levels of output, employment and incomes, government intervention may be necessary to achieve appropriate adjustment. This intervention will be directed at tackling the region's structural problems and/or the locational factors influencing efficiency.

UK central government has attempted to induce relative price and cost changes in depressed areas by means of a variety of regional policy measures. Prominent among these measures have been capital subsidies and, less often, subsidies to labour costs. Much of government policy, particularly during the 1960's, was aimed at solving structural problems by directing investment and jobs towards regions such as Scotland and away from the then relatively prosperous West Midlands and the South-east. Specific locational factors are more difficult to identify and, therefore, to deal with. Government spending to improve the economic infrastructure by reducing costs and increasing industrial efficienty help to resolve both types of problems.

To the extent that these policies do not resolve the region's problems, other subsidies and transfers are necessary. These are most usually given to individuals in the form of welfare payments to alleviate the consequences of low incomes and unemployment. Such transfers help to maintain the region's income level.

The revival of nationalism in Scotland highlighted the absence of autonomy in institutions and of freedom in economic relationships. Dependence on decisions taken in Whitehall for the UK as a whole was seen as limiting the range of possible solutions to Scotland's difficulties.

A country which is not involved in a full union like that of the UK and which experiences falling exports and rising imports will tend under the present exchange-rate system to experience adjustment brought about by exchange-rate depreciation. Such depreciation raises the domestic prices of imports and reduces the foreign currency prices of exports. Demand may then be switched from imported goods to domestically produced substitutes; domestic production may be stimulated; and supplies of exportables increased.

Scotland shares a common sterling exchange rate which varies in response to changes in the circumstances of the UK as a whole. A separate exchange rate which adjusts to reflect the particular conditions in Scotland might have the merits of preventing higher unemployment and of possibly leading to an expansion of output, although higher import prices would have a depressing effect on real incomes. In contrast, regional policy, financed through 'external' aid, may be thought to have left more unemployment but with higher incomes for those employed.

Exchange-rate depreciation would influence, however, all the goods and services which Scotland trades internationally or interregionally. Protecting all sectors more or less equally may involve prolonging the lives of weak and inefficient firms and supporting, possibly at the cost of lower real incomes, firms which are already able to compete. In terms of the geographic distribution of industrial activities, the more prosperous North-east, with its development of oil-related activities during the 1970s , and the East, where much of the recent investment in, for example, electronics has been located, probably do not require the same degree of economic aid as areas such as the Clydeside conurbation and West-central Scotland generally which have been heavily dependent on the declining, traditional industries.

Regional policy measures are financed by transfers to the subsidized region at the expense of others. Such transfers may involve a misallocation of UK resources which may inhibit UK national economic growth. This possibility is likely to be less relevant with high levels of employment for the UK as a whole when the use of excess capacity in depressed regions may permit the expansion of output. Transfers among regions may also be politically unpopular in the regions providing the resources. In contrast, an exchange rate depreciation does not require such direct payments. Rather it would involve a shift in demand away from the firms in the relatively prosperous regions to Scottish firms in response to changes in relative prices.

UK regional policies have typically been investment-orientated. In the 1960s and 1970s development grants were widely available. More recently, there have been campaigns to attract specific mobile firms, especially those from abroad which are thought to have particularly beneficial characteristics. There are now also concentrated programmes of infrastructural provision as in the Glasgow Eastern Area Renewal (GEAR) project and more comprehensive 'packages' as in the enterprise zone at Clydebank and those scheduled for Invergordon and Tayside. It may be that these more-specific measures will be more effective on balance than the less-selective approach of exchange-rate adjustment.

A separate exchange rate, or for that matter independence in economic policy, may not, of course, lead to appropriate adjustment. The UK as a whole, for example, has not been particularly successful in resolving its economic difficulties. But the nationalist case was essentially that Scotland, particularly in the circumstances of the 1970s, would fare better outside the UK union. Much of the argument rested on the potential impact on the structure and performance of the Scottish economy of having oil and gas revenues accruing to and controlled within Scotland. These revenues, it was argued, would transform any deficit in Scotland's transactions with other countries into a surplus and provide resources to regenerate Scotland's industrial base. Higher levels of employment and income might be generated directly by investment in new manufacturing activities and indirectly through linkage and multiplier effects. Outdated capital stock might be replaced and infrastructural provision improved to raise productivity levels. Improved employment prospects in a more prosperous economy would, it was felt, slow down or stop the emigration of skilled labour and might attract back some earlier emigrants.

Leaving aside legal and political aspects of claims to ownership of oil and gasfields in the North Sea, independence might not automatically resolve Scotland's problems. It may be difficult to identify those activities in which Scotland is likely to have a comparative advantage. But, even if that could be done, a substantial injection of investment demand might exert upward pressures on the prices of factor inputs and products. There might also have to be increased imports of capital and intermediate goods to develop and operate new enterprises and of consumer goods as incomes are increased through multiplier and linkage effects. In addition, even with oil and gas revenues, output and employment in an open economy like Scotland would still probably be very susceptible to changes in the levels of economic activity in major trading partners. Most importantly perhaps, there might be upward pressures on an independent Scottish exchange rate which would be determined mainly by the oil surplus rather than by the economic health of the industrial base. A appreciating exchange rate would adversely affect non-oil Scottish production in the same way as appears to have happened for the UK during the 1970s.

It is, of course, difficult to compare the theoretical possibilities of untried options with the outcome of regional policies, some of the shortcomings of which may be due to problems of implementation. Clearly the hypothetical arguments associated with independent control of economic policy, and with its outcomes with respect, for example, to exchange-rate changes, would depend on whether independence were achieved with or without substantial oil and gas revenues and on the particular form of economic strategy. However, the possibilities of separate exchange-rate adjustment and of using oil and gas revenues are not available to Scotland within the UK union. Making them available would require fundamental changes in Scotland's economic relationships with RUK and in the UK political structure. Whether such changes are desirable is probably in large part a matter for an individual's political judgement.