

Quarterly Economic Commentary

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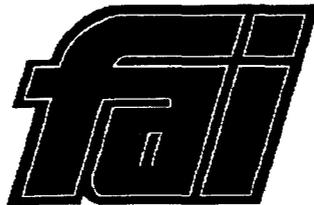
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QUARTERLY ECONOMIC COMMENTARY

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OUTLOOK AND APPRAISAL

The latest Scottish Office estimates of output in the production and construction industries in Scotland indicate that output rose by 0.1% in the fourth quarter of 1993. For 1993 as a whole output in Scotland in these sectors rose by 1.9% compared with 1.7% in the UK. In manufacturing during 1993, the differential performance against the UK was even more in favour of Scotland with output rising by 2.5% compared with 1.7% in the UK. Examination of the individual manufacturing sectors suggests that Scotland's superior performance during 1993 was largely due to the spectacular growth of 24% achieved in electronics and electrical engineering. In almost all other manufacturing sectors except transport equipment, growth was lower than in their UK counterparts as Table 1 shows.

Indeed apart from electronics, only transport equipment and other manufacturing showed any growth at all. All other manufacturing sectors continued to decline and, for the bulk of Scottish manufacturing, the recovery started weakly in 1993. The mechanical engineering sector declined by 14% which reflects the collapse of the offshore fabrication market and difficulties in market niches such as power generation plant and mining equipment. The metals and metal products sector declined by 12%, reflecting the effects of the run down of the Scottish steel industry and the weakness in aluminium smelting.

Outside manufacturing, the Scottish economy

clearly underperformed the UK in the natural resources industries during 1993. In mining and quarrying, the UK growth of 10% reflects the rapid expansion of North Sea oil and gas output. The North Sea is not part of the Scottish economy, although the onshore exploration, development and production and support activities are. The former are in sharp decline and this has dampened the Scottish performance. In electricity, gas and water, the fall in Scottish output is related to the closure of steel plants, smelters, oil construction yards and the general difficulties of Scottish engineering.

Scottish construction activity, on the other hand, was buoyant in Scotland for much of 1993, although output fell by 1.6% in the final quarter of the year compared with a 0.8% increase in the UK as a whole. Over the year, activity grew by 3% in Scotland while the sector contracted by 2% in the UK. A strong trend in public sector infrastructure work more than offset the decline in private residential, industrial and commercial construction activity, with demand in these sectors tending to be stronger in Scotland than nationally.

So, during 1993, both the construction and manufacturing sectors performed better than in the UK while the natural resource industries performed much worse. The better performance of the construction industry is largely a consequence of the more favourable conditions enjoyed by the Scottish economy generally during the recent recession. However, the same cannot be said for manufacturing where the performance of the electronics industry enjoying strong export sales has tended to mask an erratic and weak performance in the rest of Scottish manufacturing compared with the UK. While Scottish manufacturing generally did not experience the depths of recession suffered by its UK counterparts it appears, by the same token, not to be experiencing as strong an upturn as manufacturing in the UK. The probability of such an outturn is supported by Scotland's recent economic history where Scottish output has tended to contract less during recessions and to expand less impressively during upswings. The main difference in the most recent recession is that the Scottish economy held up even better than in earlier downturns.

In the first quarter of this year, both UK GDP and the output of the production industries rose by 0.7% over the previous quarter. Manufacturing output turned in a brisk performance of 1.3%, while the service sector expanded by 0.6%. Unfortunately, data on first quarter output performance for the Scottish economy will not be available until the second week of August. The main indication of Scotland's current performance is from business surveys. The SCBS for the first quarter 1994, reported further increases in Scottish business confidence, demand and investment intentions for plant and equipment. The recovery appeared to be becoming more broadly based, although the responses indicated some slowing in the rate of growth of demand. Generally, business confidence and demand growth appeared to be weaker than in surveys covering the whole of the UK. However, expectations for the second quarter were for faster demand growth, but it remains to be seen whether this will be sufficient for recovery in Scotland to keep pace with the rest of the UK.

The labour market

In 1993, total employees - which comprise employees in employment, the self employed and government trainees - fell by 30,000 (1.5%) compared with a 1.4% fall in Britain. These and other details of the Scottish and British workforce are set out in Table 2. Within this total, the number of government trainees fell by 8,000 (18%), amounting to half of the British fall of 15,500. Self employment rose by 14,000 (6%) due to a remarkable increase of 11,250 (22%) in female self employment. The Scottish increase in female self employment was actually greater than the British rise of 10,500. The reasons for this significant growth in Scottish female entrepreneurship are unclear but may reflect a change in employment practice whereby people are invited to become self employed in order to lower wage and non-wage labour costs. Despite this strong growth in self employment, employees in employment fell by 24,000 (1.1%) which is less sharp than the 1.3% fall experienced in Britain as a whole.

Within this change in total employment, three well-known trends were evident. First, there was a continuing shift in favour of female employment. Male jobs contracted by 28,700 (5.9%) while female jobs fell by a mere 1,300 (0.2%). This shift was more marked in Scotland than in Britain, with the result that by the end of last year females accounted for 49.9% of Scottish employees compared with 49.3% in GB. Secondly, part-time

jobs rose by 9,250 (1.8%) while full-time employment declined by 39,250 (2.7%). Finally, the shift towards services continued despite a small fall of 1,664 (0.1%) jobs in the sector. This trend in part accounts for the growth in part-time working which appears to have accelerated in services since full-time equivalent employment fell by 6,625 (0.6%) in the sector.

During 1993, Scotland experienced sharper falls in manufacturing and construction employment than in Britain. The drop in manufacturing jobs is a reflection of the poor manufacturing output performance in all sectors except electronics. The sharp drop in construction employment appears puzzling in view of the strong trend in output. However, three factors appear to be relevant. First, the less labour intensive public civil engineering projects appear to be supporting output growth while demand for the more labour intensive residential and commercial projects remains weak. Secondly, there appears to be an ongoing trend favouring the substitution of self-employed workers for employees in order to reduce overheads given significantly weak contract prices. Finally, there is a drive to secure greater productivity from existing employees. Taken together, these three factors may provide some reconciliation between the strong output and poor employment performance of Scottish construction.

Table 2 indicates that despite the fall in total employment of 30,000, unemployment increased by only 1,800 (0.7%) between the two years, which compares favourably with the 3.2% increase evident in Britain. Indeed, claimant unemployment fell during 1993 but the fall was not fast enough to ensure that the average jobless total fell between 1992 and 1993. Table 2 makes clear that the growth in Scottish unemployment as employment fell was checked by a 22,300 (0.9%) fall in the workforce whilst the GB total declined by 221,350 (0.8%).

Work undertaken in the Institute using the Labour Force Survey has allowed the construction of a set of labour market accounts for the periods March-November 1992 and 1993. While these data are not directly comparable with the data from the DoE presented in Table 2 they do give some indication why the change in unemployment in Scotland has been small in relation to the change in employment and more favourable than the GB unemployment performance. What this work shows is that of the drop in employment of 45,000 (2%) in Scotland between the two periods, 11% was associated with increased unemployment, 22% was associated with

a drop in the 16+ population and 67% was associated with a rise in the numbers economically inactive. In Britain, in contrast, a smaller proportionate drop in employment of 0.6% (159,667) was compounded by a *rise* in the 16+ population of over 97,000. From this combined excess labour supply of 257,000, 52% was associated with increased unemployment and 48% with a rise in the numbers economically inactive. Accordingly, we can say that the better Scottish unemployment performance in 1993 was due to a favourable demographic situation (loss of population) and a stronger 'discouraged worker' effect (rise in the economically inactive) despite a poorer jobs performance. Moreover, the research also indicates that just under 50% of the rise in the economically inactive in Scotland was accounted for by a 13.5% increase in the number of 16-19 year olds in full-time education. Moreover added to this will be an increased but unknown number of older students entering full-time education. The education system in Scotland appears to have served as something of a shock absorber in the face of a sharp fall in labour demand.

Short-term outlook

The market for Scottish goods and service will continue to improve during 1994. The outlook for 1994 and 1995 is distinctly better than the outturn in 1993. World GDP is set to grow by over 3% this year and the economies of Scotland's principal trading partners in the EU are beginning to recover. The US economy, which is Scotland's third largest trading partner, is growing strongly benefiting Scottish textiles and drinks exporters. However, inflationary pressures are appearing in the US and it must be expected that tighter monetary policy in the form of higher interest rates will serve to moderate the growth of US domestic demand.

The UK is closer to the US in its recovery profile than it is to its principal EU partners. In the first quarter of the year, UK manufacturing output was growing strongly stimulated by rising domestic demand as evidenced by strong retail sales growth. Inflation remains low in the UK despite the recovery of consumer demand. Strong price competition, continued moderation in the growth of average earnings and a fairly stable exchange rate are assisting the relative price stability. However, with expanding demand at the present level of base rates, price and wage pressure are likely to be considerably higher next year. It must therefore be expected that interest rates will rise this year because the lagged effect of an interest rate change

can be a year or more ahead. However, the danger for both the Scottish and UK economies of pushing up interest rates earlier rather than later, is the continuing uncertainty about the strength of the recovery. This has even more force for Scotland where the recovery has so far lagged behind the UK as a whole. The markets are taking the view that an increase in base rates should come sooner rather than later, although there are some grounds for believing that the markets are overestimating the inflationary threat. Nevertheless, it seems probable that an increase in interest rates will be warranted in the near future for domestic reasons. There may also be external pressures for higher rates if US rates rise further in an attempt to control US domestic demand. Without some increase in British rates, downward pressure on sterling would build up generating inflation fears on that account. We therefore expect that base rates will be at 6% or more by the end of the year.

Projected interest rate increases will have some dampening effect on growth in 1995, although other factors are more favourable for growth in both Scotland and the UK next year. For 1994, we expect that recovery in Scotland will continue to lag behind the rest of the UK, principally because of Scotland's more exposed international trading position and the disproportionate impact here of the tax rises and public expenditure cutbacks. We are predicting that Scottish GDP growth will be in the range from 2.25% to 2.5% compared with around 3% for the UK as a whole. For manufacturing output, our short-term model is predicting a year-on-year growth rate of 3%, with output growing steadily throughout the year except for the third quarter. This reflects further strong growth in electronics and electrical engineering as new capacity comes on stream and recovery occurs in key EU markets. The prospects for other manufacturing sectors are more subdued. We expect that Scottish employment will continue to fall in 1994. The number of employees is projected to decline by 12,000 to 13,000 with a further reduction of 1,750 trainees. The growth in self employment will continue by around 5,000. On the basis of an expected further fall in working population and no strong trend in labour market participation we continue to expect that average unemployment in 1994 will be little changed from 1993 and may show a small rise of around 1,000. This jobless forecast could easily be overturned given the variation in the supply-side adjustments that can occur in the labour market which were noted in the labour market section above. Nevertheless, we are reasonably confident that the projected levels of

output growth for 1994 and continuing productivity increases will result in a further fall in labour demand in Scotland this year and only a small increase in the UK.

21 June 1994

Table 1 Output Change in Scotland and the UK between 1992 and 1993

	Scotland	UK
	%	%
PRODUCTION & CONSTRUCTION	1.9	1.7
PRODUCTION	1.6	2.5
Mining, Quarrying (Oil)	-2.0	3.0
Electricity, Gas & Water	-2.6	3.0
MANUFACTURING	2.5	1.7
Oil Refining & Nuclear Fuel	-4.0	2.0
Chemicals	-2.0	3.0
Metals & Metal Products	-12.0	0
Engineering	8.0	2.0
<i>of which</i>		
Mechanical Engineering	-14.0	-1.0
Electrical & Instrument Engineering	24.0	7.0
Transport Equipment	1.0	-2.0
Food & Tobacco	0	0
Drink	0	3
Textiles, Clothing & Footwear	-1.0	1.0
Paper, Printing & Publishing	0	4.0
Other Manufacturing	1.0	3.0
CONSTRUCTION	3.0	-2.0

Source: Scottish Office 11 May 1994

Table 2
British & Scottish Civilian Workforce
1992-1993

	Scotland				Great Britain			
	1992	1993	Change 92/93		1992	1993	Change 92/93	
			abs	%			abs	%
Primary Sector	84387	81658	-2729	-3.2	652205	603777	-48428	-7.4
Manufacturing	362142	346395	-15747	-4.3	4343219	4191116	-152103	-3.5
Construction	117048	107135	-9913	-8.5	877214	806349	-70865	-8.1
Services	1426601	1424937	-1664	-0.1	15241884	15217526	-24358	-0.2
Production	419708	401896	-17811	-4.2	4736582	4541110	-195472	-4.1
Total Employees	1990177	1960124	-30054	-1.5	21114521	20818768	-295753	-1.4
Self Employed	235750	249750	14000	5.9	2906750	2909750	3000	0.1
Government Trainees	44750	36750	-8000	-17.9	330500	315000	-15500	-4.7
In Employment	2270677	2246624	-24054	-1.1	24351771	24043518	-308253	-1.3
Unemployed								
level	240516	242294	1778	0.7	2698041	2784939	86898	3.2
rate (%)	9.6	9.7			10.0	10.4		
Civilian Workforce	2511194	2488918	-22276	-0.9	27049812	26828456	-221355	-0.8

Source: Department of Employment