

Quarterly Economic Commentary

**we gratefully acknowledge the contribution of the
Buchanan and Ewing Bequest
toward publication costs**

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Information for subscribers

The Quarterly Economic Commentary is published in March, June, September and December. Annual subscription rates are £50.00, or £15.00 per single issue. Queries should be addressed to the Secretary, the Fraser of Allander Institute.

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QUARTERLY ECONOMIC COMMENTARY

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OUTLOOK AND APPRAISAL

The most recent Scottish Office estimates of output in the production and construction industries indicate that output grew by 0.9% in the first quarter of 1994. The UK, by comparison, grew at the marginally slower rate of 0.8%. Within these aggregates, construction continued to perform better in Scotland (2.2% compared with 1.1% in the UK) while the production industries performed less strongly (0.5% compared with 0.8% in the UK). However, manufacturing, which accounts for 83% of activity in the production industries, grew at the slightly faster rate of 1.6% in Scotland compared to 1.5% in the UK, but this was largely due to the stronger performance of petroleum products & nuclear fuel (11% compared with -11%) and metals & metal products (9% compared with -2%). All other principal manufacturing sectors in Scotland performed either the same or worse than their counterparts in the UK. Even electrical & instrument engineering, or electronics, while continuing to exhibit strong growth, performed less robustly than its UK counterpart (4% compared with 5% in the UK).

A better understanding of the relative performance of the Scottish economy can be obtained from an analysis of changes in output over periods longer than a quarter. Erratic short-term quarterly movements can obscure longer-term trends. Figure 1 plots the differential output performance of construction and the principal manufacturing sectors in Scotland relative to the UK in both the recent recession and subsequent recovery. The recession is defined as occurring from the first half of 1990 to the fourth quarter of 1991, while the recovery period spans the period from the first quarter 1992 to the most recent data point i.e. the first quarter 1994.

The figure indicates that three sectors, accounting

for 39% of production and construction activity, electrical & instrument engineering (electronics), construction and textiles, outperformed their UK counterparts in *both* recovery and recession. The electronics industry outperformed its UK counterpart by over 15 percentage points in the recession and by over 32 percentage points in the recovery. The strong performance of electronics during both phases of the cycle was sufficient to ensure that both manufacturing and the output of the production industries as a whole also outperformed the UK in recession and recovery. Removal of the electronics industry pushes both manufacturing and production into the south-west quadrant of the figure (not shown), indicating a poorer performance than the UK in the two phases of the cycle.

Two sectors, accounting for just over 6% of activity, oil refining & nuclear fuel, and metals & metal goods outperformed their UK comparators during the recovery but performed relatively less well during the recession. Conversely, 5 sectors, accounting for 33% of activity, mining & quarrying, mechanical engineering, electricity, gas & water, drinks and paper, printing & publishing did better in the recession but fared less well in recovery. Which leaves three sectors, accounting for 15% of activity, whose performance has been clearly below their UK counterparts throughout the cycle: chemicals & fibres, transport equipment, and food & tobacco.

What these figures reveal is that generally Scotland's output performance (excluding the service sector) has been stronger than the UK throughout the cycle but that this has been due to a strong relative performance in construction and, within production and manufacturing, the buoyancy of the electronics sector. In the recovery phase, Scotland's better performance to the first quarter in production and manufacturing, has been less pronounced and more focused than in the recession being exclusively due to electronics, but supported by textiles, oil refining & nuclear fuel, and metals and metal goods.

The labour market

The data on the labour market are increasingly

sending confusing signals about the behaviour of employment and unemployment in both Scotland and Britain. The Department of Employment (DOE) data show that over the year to June 1994, the number of employees in Scotland fell by proportionately more in Scotland than in GB. Scottish employees fell by 1.1% while the fall in Britain was only 0.5%. Within these aggregates, full-time working in Scotland fell by 2.2% compared with a 1.5% fall in GB, while Scottish part-time working *rose* by 1.9%, slightly less than the 2% rise in Britain. Full-time equivalent (FTE) employment (where 3 part-time jobs are taken to be equivalent to 1 full-time job) therefore fell by 1.7% in Scotland over the period against a 1.1% fall in Britain. However, while male FTEs in Scotland fell by more than in Britain, a 2.6% fall compared with a 1.5% reduction, female FTEs in Scotland fell by slightly less, contracting by 0.5% while British female FTEs fell by 0.6%. The generally poorer Scottish employee performance compared with GB over the year to June 1994 is not, however, evident over a longer phase of the current cycle, reflecting the greater buoyancy of the Scottish economy as noted in the previous section. If June 1991 is taken as the base (i.e. equal to 100) then the index for FTE employees in June of this year stood at 96.4 in Scotland compared with 94.7 in Britain. Indeed, when the number of employees alone is considered the gap in Scotland's favour is even greater, with the index standing at 98.3 compared with 96.2 in Britain. This greater positive differential reflects the stronger growth of part-time working in Scotland.

The DOE figures are not the only source providing information on developments in the labour market. In addition, there is the *Labour Force Survey* (LFS) which is based on quarterly household surveys, whereas the DOE survey uses a representative panel of employers. A proper comparison of the employment series from the two surveys requires an adjustment to be made to the DOE series, using the procedure recommended by the National Institute for Economic and Social Research in its *August Review*, to allow for differences in the timing of the collection of the data in a given period(1). However, even after this adjustment there are considerable differences between the two surveys in their estimates of recent change in both employment and unemployment. Over the year to the latest comparable datapoint, May 1994, the DOE series estimates the numbers in employment(2) to have *fallen* in Scotland by 0.4% or just over 8,000 jobs, while the estimate for Britain is an *increase* of nearly 0.2% or 38,000 jobs. The LFS, on the other hand, shows the

numbers in employment *rising* in Scotland by 1.4%, or 31,000 jobs, while in Britain total jobs increased more slowly by 0.7%, or 169,000.

Similarly, when estimates of unemployment from the DOE's separate claimant count are compared with those obtained from the LFS, considerable differences are revealed. The total claimant count in Scotland is seen to have fallen between May 1993 and May 1994 by just under 5% or nearly 12,000, while the GB fall has been faster at over 8% or nearly 243,000. The LFS, in contrast, suggests that unemployment in Scotland has hardly fallen at all over the year, by 1,000 or 0.4%, while the drop in GB unemployment is somewhat less than the DOE estimate, 189,000 or nearly 7%. Moreover, when the different estimates of job and unemployment change are put together to provide a simple set of labour market accounts, the two surveys offer a radically different picture of adjustments in the Scottish and British labour markets over the period. On the DOE data, the fall in both employment and unemployment in Scotland is associated with a loss of population and a *fall* in the numbers economically active by 20,000 or 0.8%. Using the LFS data, the rise in employment and small fall in unemployment, with the given population loss, is associated with a *rise* in the numbers economically active by 30,000 or 1.2%.

So, the LFS data paint a picture of a labour market in Scotland where jobs are being created at a fairly brisk pace but with limited effect on unemployment due to people returning to the labour market as the number of economically inactive persons falls. The DOE data, in contrast, depict a labour market where jobs are still being shed but, with a significantly greater fall in the numbers economically active due to people leaving the labour market, the number of unemployed is shown also to have fallen appreciably.

Evidence of such a radical difference between the two surveys begs the question, which survey offers a more accurate picture of the state of the Scottish labour market? The DOE employment data probably understate the number of jobs being created in small firms in the service sector which may not be fully represented in the employer sample, while the same data set can overstate the number of people with jobs since a person with jobs with two different employers would be counted twice. The LFS since it focuses on people is less prone to such error. On the unemployment side, the DOE data include only claimants, while the LFS covers only those who looked for work in the 4

weeks prior to the Survey, irrespective of whether they were benefit claimants. The DOE data will therefore serve to underestimate the unemployed to the extent that there are many, e.g. females, who are ineligible for benefit, but will overstate the unemployed to the extent there are benefit claimants who are not seeking work i.e. who are economically inactive. Conversely, the LFS will understate the numbers of long-term unemployed who have looked for work, continue to wish to work, but who have not sought work in the 4 weeks preceding the Survey. It therefore follows that neither data set is likely to be completely satisfactory in its representation of the labour market.

A partial reconciliation of the two data sets on the labour supply side is possible if, as is frequently suggested, claimants were being moved during the period from unemployment benefit to other forms of benefit where they do not formally have to seek work. In such a situation, the DOE unemployment numbers and those economically active would both fall, while, if the individuals had not actually been seeking work when in receipt of unemployment benefit, there would be no change on this account in the numbers unemployed or economically active in the LFS. This is broadly in line with what the two data sets show, with the addition that the more accurate recording of job change in the LFS has contributed positively over the year to the numbers economically active. It is reported that the government believes that the LFS provides a more accurate picture of behaviour in the labour market during the year to May 1994. However, if this is correct, and the argument above suggests that neither data set is completely satisfactory, then it must also be recognised that Scotland's relative unemployment performance during the period was less favourable than indicated by the DOE data.

Short-term outlook

The pace of growth is quickening in the British economy (see **UK Economy** section) and Scotland stands to benefit from the general recovery both in the British and world economies. Our short-term model is predicting that manufacturing output will continue to rise over the five-quarter time horizon to the second quarter 1995 with a brief dip in output in the third quarter of this year. Year on year, the model is predicting a 3.1% increase in manufacturing output in 1994. Scottish GDP growth in 1994 should be around 2.5% with UK growth nearer 3%. These forecasts are little different from those presented in the June **Commentary**.

However, we are somewhat more sanguine about Scotland's labour market prospects than we were in June. We expect that FTE employment, as measured by the DOE, will fall over year, due to the poor start, by about 12,500, a 0.8% decrease. In job terms, the number of employees should fall by about 7,000, suggesting a continuation of the shift towards part-time working. Females will steadily become a bigger majority of Scottish employees. Self employment is expected to rise by about 4,400 whilst government backed trainees are expected to fall by 1,700, and there should be a further fall of HM forces in Scotland by about 700. Taken together these forecasts suggest that in 1994 the workforce in employment will fall by around 5,000. Unemployment has continued to fall this year and we expect that the claimant count will be down by around 12,000 in 1994 compared with 1993, but largely as a result of falling working population and a further reduction in measured labour market participation.

Looking to the medium term, we expect that Scotland will experience fairly fast growth in the next two years and that the demand for labour will start to rise which, indeed, is likely to be presently under way. Future prospects are clearly also contingent upon developments in both the UK and world economies. The recent increase in the UK base rate is paradoxically more likely to enhance medium-term growth than diminish it. There will be an immediate slight dampening effect on demand, but in the medium term if the rise and projected future increases as the recovery continues, serve to enhance the credibility of British monetary policy then long-term bond yields should fall, helping to stimulate investment and reduce future inflationary pressure.

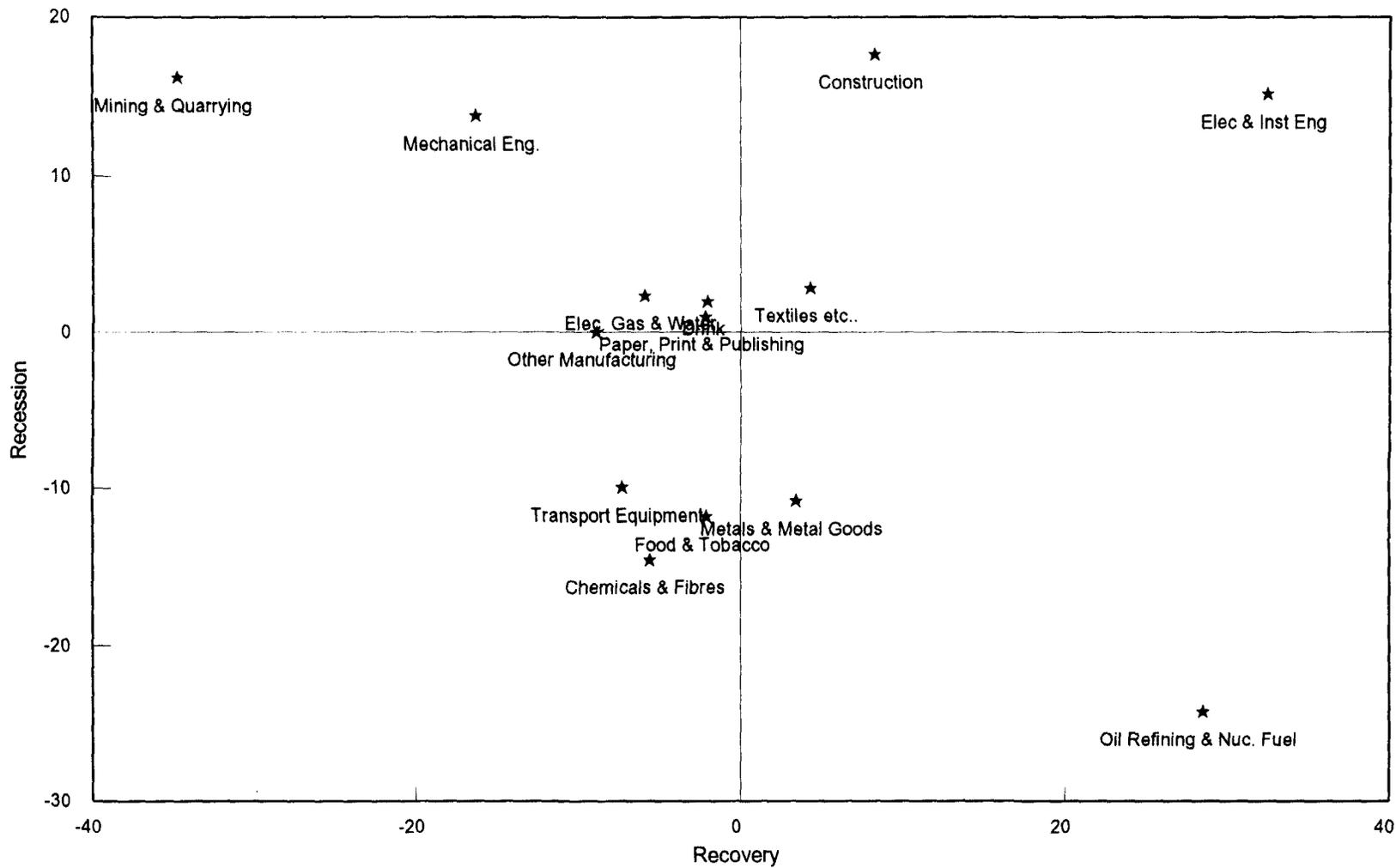
22 September 1994

1. The NIESR *Review* points out that the DOE estimates are benchmarked on the end month in a particular quarter, whereas the LFS estimates relate to a three-month period across quarters. The DOE figures are therefore adjusted to be comparable with the LFS quarter's figures by applying a two-thirds weight to the earlier, and a one-third weight to the later DOE quarters.

2. The numbers in employment are the sum of the numbers of employees, those on government training programmes, and the self employed.

FIGURE 1

Scottish Sectoral Output Growth relative to UK (%)



Source: Scottish Office, FAI