Quarterly Economic Commentary

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QUARTERLY ECONOMIC COMMENTARY

* * * * * * CONTENTS* * * * * *

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OUTLOOK AND APPRAISAL

The latest output data from the Scottish Office for the third quarter 1994, indicate that both production and manufacturing are growing more quickly in Scotland than in the UK, while in construction, the industry generally continues to contract but at a faster rate in Scotland. In comparison with the second quarter 1994, the output of the production industries in Scotland rose by 2.2% compared with 1.3% in the UK; manufacturing output also rose by 2.2% against 1.2% in the UK, while construction registered a 4.4% *fall* in output here, in contrast to a 1.3% *fall* in the UK as a whole.

However, a longer perspective offers a less favourable comparison. Over the year to the third quarter 1994, the output of the production industries rose by 4.1% in Scotland and by 5.8% in the UK. Manufacturing output rose by 4.7% here, against 4.8% in the UK. And construction activity *fell* by 9.3% north of the border compared with a 2.3% *increase* in the whole of the UK. When the average of the latest 4 quarters is compared with the average of the preceding 4 quarters, the comparison produces more mixed results. Over this period, production output rose by slightly less in Scotland, by 4.3% compared with 4.7% in the UK. Scottish manufacturing production increased more quickly, by 5.3% against a UK increase of 3.1%. And, Scottish construction activity *contracted* by 2.2%, while the same sector in the UK expanded by 2.4%.

A final useful comparison, is to compare the relative performance of the two economies during the recovery from recession i.e. from Q2 1992 to Q3 1994. Since the trough of the recession, Scottish production has risen by 8.2% compared with 9.5% in the UK. Manufacturing output in Scotland has risen by 9.7%, easily outstripping the 6.4% rise recorded by manufacturing in the UK. Construction, on the other hand, appears to have behaved counter cyclically in Scotland, falling by 2.8% since Q2 1992 (after an increase of 4% during the "recession"), while the sector in the UK has registered a small increase of 0.7%.

The figure provides a sectoral breakdown of Scotland's relative performance during the above mentioned recovery period. The importance of electrical and instrument engineering (electronics) to Scotland's recovery can again be clearly seen. The arbitrary removal of the direct contribution of the electronics sector, produces a counterfactual fall in Scottish production output of 4.8% compared with a rise of 8% in the UK. Manufacturing output falls by 6.6% as against a 4.2% rise in the UK. While the rest of the engineering sector falls by 22.1%, in contrast to a 1.7% rise in the output of that sector in the UK. As noted in previous **Commentaries**, outside electronics only a very small number of sectors have experienced positive growth during the recovery. Mining & quarrying, and electricity gas & water, display positive growth of 2.7% and 1.1% respectively, although both display considerably less growth than their UK counterparts. And within manufacturing, the published data show that only one sector, chemicals & fibres, has experienced positive growth, 7.4% against 10.6% in the UK.

We must conclude from this that since Q2 1992, the recovery of Scottish production has been very narrowly based. However, in recent quarters there is growing evidence that the recovery is becoming more widely spread. Manufacturing sectors such as metals & metal products, food & tobacco, drink, textiles, clothing & footwear, and other manufacturing, have all displayed positive growth, either in the latest quarter, or over the most recent 4 quarters compared with the previous 4. Nevertheless, the continuing reliance on electronics for much of Scotland's growth remains a cause for concern. First, because it increases the vulnerability of the economy to a cyclical downturn in that sector. And, second, because the relatively low degree to which the sector is linked into Scottish suppliers (about 14% of non-labour inputs to electronics are sourced locally) and the capital intensity of the sector, implies that the feed-through effect of electronics growth to domestic consumer demand is relatively weak. So, for example, the extent to which Scottish retailing has benefited from the strong growth of electronics during the recovery has been minimal.

Scotland and the GB Labour Market

In February, there were 207,900 (on a seasonally adjusted basis) unemployed in Scotland on the claimant count. This represents 8.3% of the Scottish workforce, the same rate as in Britain. The Scottish unemployment rate has been falling since December 1992. But the slower rate of decline here led to the GB rate falling below the Scottish rate in July last year, thus removing the unemployment advantage which the country enjoyed during the recession. Since July, the Scottish rate has been broadly the same as the British rate.

The data still leave much room for argument on the extent to which job creation during the recovery accounts for the drop in the jobless total. In previous **Commentaries** the Institute has drawn attention to the marked differences that have existed between the two official series: the Department of Employment (DOE) survey of businesses and the Labour Force Survey (LFS) of households. In 1993, the two surveys offered radically different pictures of the change in both the Scottish and GB labour markets. The LFS indicated stronger jobs growth and appeared to be offering a more plausible description of labour market change during economic recovery. The DOE data were, on this account, much criticised. In March, significantly revised estimates of job change were provided by the DOE. The upshot of which was to raise the estimates of job creation bringing the dataset more into line with the LFS. The implications of these revisions and remaining differences with the LFS are analysed in some detail for Scotland, other GB regions and Britain as a whole, in the **Regional Review** elsewhere in this **Commentary**. We content ourselves here with some general observations on recent labour market change which are drawn from that analysis.

First, the DOE revisions have added another 30,000 jobs to the Scottish economy at September 1994 compared with earlier estimates. This has the effect of reducing the job loss in Scotland over the previous two years to 13,571 (0.75%) from 27,730 (1.4%). Britain, on the other hand, now shows a small increase of 0.3%, whereas previously employment had been flat over the two years to September. Secondly, these rediscovered jobs are primarily male full-time jobs in the construction sector. As a result, the conclusion that females now constitute a majority of employees appears to be premature. Thirdly, considerable differences still remain between the two series. Both series suggest that Scottish jobs fell by 14,000 in the quarter to December 1994. However, the series diverge when longer time periods are considered. For example, in the year and two years to December, the LFS suggests that employment rose by 18,000 and 15,000, respectively, while the DOE series indicates *falls* of 37,000 and 27,000 in the two periods. Moreover, in the most recent quarter when the two series indicate the same aggregate jobs change, there are considerable differences between the two in the gross components of the change. For example, in the DOE series the 14,000 job loss comprises an 8,000 reduction in male employment and a 6,000 reduction in female jobs. The LFS, in contrast, suggests that the aggregate change comprised a 16,000 reduction in male jobs and an *increase* of 2,000 in female workers.

Finally, the labour market accounts provided in the **Regional Review**, indicate that the two series paint markedly different pictures as to why unemployment is falling in Scotland and to a lesser extent in GB. In Britain, between 1993 and 1994[1] the fall in unemployment reflects the outcome of job creation and a falling activity or participation rate against the background of an increase in population. The difference between the DOE and LFS series is that, in the former, job creation only accounts for 33% of the drop in unemployment whereas, in the LFS, job creation represents 77% of the fall. So the difference between the two series is a matter of degree. Much the same can be said for the other groupings of GB regions considered. However, for Scotland, the fall in unemployment of over 14,000 is associated in the DOE series, with a *drop* in employment (of around 7,000) and a three-times greater *fall* in participation, against a background of falling population. The LFS series, in contrast, has jobs rising by over 31,000 and participation rising by about 17,000. With the Scottish economy growing by over 3% in output terms during this period, the LFS appears to offer a more plausible story. Yet the LFS is not without its problems (see **Regional Review**). This continuing saga of a tale of two series suggests that consideration should be given to increasing the public expenditure devoted to the British employment count, preferably with standardisation on an expanded LFS.

In our view the Scottish labour market is performing a little less well than suggested by the

[1]Actually, between the averages of Feb. '93 to Nov. '93, and Feb '94 to Nov '94.

LFS. It seems likely that the LFS is overstating the growth of female employment. The LFS suggests that between 1993 and 1994[2], the growth of female employment was 4 times faster in Scotland than in GB, 4 times faster than in the Midlands & Wales, and 3 times faster than in the South of England. Nevertheless, we believe that employment in Scotland and GB is currently rising quite quickly. Reductions in unemployment now appear to be increasingly due to job creation rather than falling participation. And the present rate of jobs growth should continue throughout 1995.

Short- and Medium-term Outlook

The UK economy is currently enjoying a balanced growth profile (see **UK Economy** section). Inflation is low. Investment is picking up. Net export demand provides the main impetus for growth. And the current account of the balance of payments is improving. Nevertheless, unless investment picks up considerably, the present rate of growth of the UK economy is probably not sustainable. Growth is therefore expected to reduce to 3.5% this year falling further to 2.5% in 1996.

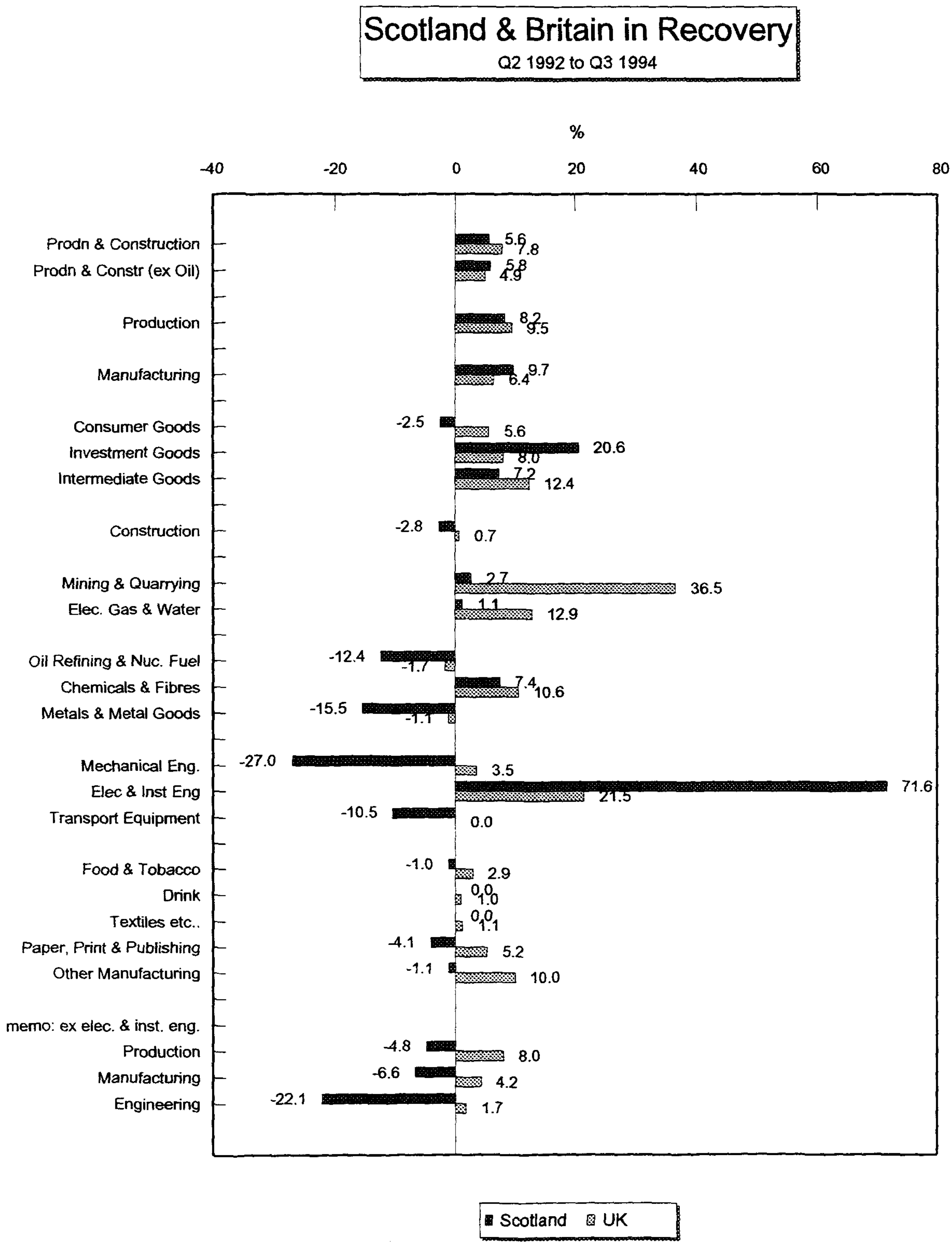
It is against this background that our forecasts for Scottish manufacturing output over the next five quarters are based. Output is expected to have risen by about 1.2% in the final quarter of last year, producing a year-on-year forecast for Scottish manufacturing output in 1994 of 3.2%. In 1995, the rate of growth in manufacturing is expected to rise in the first quarter, remaining positive until the final quarter of the year. For 1995 as a whole manufacturing output growth is forecast to be in excess of 4%. Strong growth in UK manufacturing and buoyant exports account for the better expected performance in 1995 compared with 1994.

We now turn to the Scottish economy's prospects in the medium-term. GDP growth is forecast to be around 3.5% in 1995 over 1994, much the same as in the UK as a whole. Over the 1994 to 1999 time horizon growth is expected to average around 2.8% per annum. Growth is expected to moderate next year and the year after to around 2.8% and 2.3%, respectively, and then continue at much the same rate in 1998, rising to 2.8% in 1999. During this five-year time horizon, manufacturing is expected to be the lead sector, with growth averaging 3.6% per annum. The other three sectors: primary, construction and services, are expected to exhibit an annual average growth rate of around 2.5% with construction possibly growing slightly faster. This predicted sectoral profile reflects strong net export growth over the next two to three years, particularly to countries outside the UK. Export growth to the rest of the world (i.e. outside the UK) is expected to reach 6% this year, falling slightly to 5.7% in 1996 and 5.1% in 1997. Imports from the rest of the world, on the other hand, are expected to grow by only 2.9% this year, falling to 2.6% in 1996 and 2.3% in 1997.

On the jobs front, total employment is forecast to increase by 21,900 jobs, or just under 1%, in 1995. Thereafter we should still expect to see positive jobs growth over the next few years but the numbers will be smaller than in the current year, with little growth evident in 1997 and 1998. This is not "jobless growth" but growth rates are expected to be much lower than GDP growth rates as productivity continues to rise strongly. In view of the expected, all be it small, positive jobs growth and projected reductions in the workforce, moderated only slightly by increasing participation, the unemployment rate should continue to fall for some time, averaging 8.3% in 1995, 7.8% in 1996 and 7.7% in 1997.

29 March 1995

[2]Proxied on the same basis as above.



Source: Scottish Office, FAI