Quarterly Economic Commentary

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OBITUARY

The staff of the Fraser of Allander Institute learned with great sadness of the death of Sir Hugh Fraser on 5 May. The Institute has been generously funded by the charitable trust set up by Sir Hugh's family, whose name it bears. It is less well-known that the initiative for the establishment of the Institute came from Sir Hugh himself, and that it was at his own suggestion that the Institute's first research project was undertaken. This was the preparation, in co-operation with the Scottish Council (Development and Industry) and with IBM's United Kingdom Research Centre, of the first-ever set of input-output tables for Scotland. Despite the authority which his experience of the world of business had given him, - only a short time earlier, Sir Hugh had been chosen by **The Guardian** newspaper as its Young Businessman of the Year - at no time did he attempt to influence the opinions or views of the Institute's staff. We are proud to salute a kind and disinterested benefactor; we should like to believe that the achievements of the Institute which he did so much to create were a source of satisfaction to Sir Hugh.

David Simpson
Research Professor

FRASER of ALLANDER INSTITUTE

The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short term movements in economic activity. Along with the Quarterly Economic Commentary the Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium term and long term aspects of the Scottish economy. The Institute is a research unit in the Strathclyde Business School, a faculty of the University of Strathclyde.

Information for subscribers

The Quarterly Economic Commentary is published in February, May, August and November. Annual subscription rates are £20.00, or £5.50 per single issue. Queries should be addressed to the Secretary, the Fraser of Allander Institute.

Notes to contributors

The editors welcome contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Scottish Editor.

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QUARTERLY ECONOMIC COMMENTARY

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Opinions expressed in signed contributions are those of the authors and not necessarily those of the Fraser Institute

Outlook and Appraisal

The outlook for the Scottish economy is favourable over the coming months, but probably less favourable than the outlook for the UK economy as a whole.

Recent evidence provided by the London Business School on the underlying performance of the **UK economy**, suggests that during 1986 the economy began to grow above its trend rate after a period of below trend growth from late 1984. We expect that during 1987 the growth rate will improve further relative to trend and probably peak in the middle to late 1988. However, there is the worrying possibility that the inflation rate may ba rising to a level which could frustrate this prediction.

Unlike the 1970s and early 1980s when output actually rose and fell over the duration of the cycle, recent cyclical movements have occurred against a background of continuing positive growth. The British economy is now entering its seventh year of positive growth, suggesting that the cyclical behaviour of the economy may now have reverted to the experience of the 1960s when cyclical movements represented successive periods of above and below trend growth rather than rises and falls in the level of output. If this in fact proves to be the case, the explanation of the change would appear to lie in the absence during the 1980s of the external shocks to the UK economy which characterised the 1970s, particularly the oil price increases in 1973/74 and 1979/80.

In other respects, though, recent experience differs from that of the 1960s. During 1986 the UK experienced faster economic growth than the major European economies and in 1987 its growth could exceed that of the US and Japan. The reasons for this improvement in Britain's relative economic performance are less than straightforward.

In the 1970s, Britain's economic cycle broadly moved in line with the cycle in the OECD countries. The major difference between the UK and world economic performance being that the cyclical pattern of UK upswings and downswings was more pronounced. From 1979, the combination of the deflationary effects of the oil price rise, and the sharp appreciation of sterling, reflecting its new-found status as a "petrocurrency" and monetary contraction, produced a severe recession as industrial output fell 6.8% below that of 1978. The recession occurred more quickly and was therefore initially more severe than the recession in the rest of the world, but by 1982 the OECD countries were experiencing a more pronounced recession while the UK had already embarked on an upward growth path. In view of the experience of the 1970s, and the earlier UK recession and upturn in 1981/82, it might therefore have been expected that following the UK peak in 1984/85 there would have followed a sustained period of below trend growth at a time when other industrial countries were either still in the upswing of their cycle, or in the early stages of a downturn. This did not happen. A trough was reached in late 1985 earlier than might have been expected at a higher rate of growth, and the economy reverted during 1986 to growth at, or above, trend, with the possibility that the trend itself may have shifted in favour of higher potential growth.

The main forces underlying the improvement in Britain's economic growth have been the strong growth in consumer spending and, perhaps more importantly, the recent statistic cotinued to fall. It should first be remembered that unemployment takes time to respond to changes in economic activity. When economic activity expands adjustments are first made to labour demand within firms' internal labour markets before employment increases as workers are hired from the external labour market (see **Labour Market** section). Even then registered unemployment may not fall because the new jobs may be filled by workers moving from one job to another, by migrants from other regions, or by labour supplied from the non-registered or "hidden" unemployed. Registered unemployment will be affected but only after a lag of perhaps nine months or more. On this basis the effects of improved UK economic growth should now be beginning to affect the unemployment register.

However, it is clear that the recovery in economic activity in Scotland is lagging behind that of the UK. Furthermore, the harmful effects of the oil-price fall on the oil supply industry have been largely localised in Scotland and while the worst is over the impact is still coming through to the unemployment register. In addition, the twelve major redundancy announcements between November and the end of January, which were discussed in the February **Commentary**, have still to register their full impact on unemployment. An analysis of the unemployment flows on to and off the register in Scotland compared with the UK, shows that in the three months to January, when unemployment was still rising in Scotland while falling in the UK, the rate of inflow on to the register rose in Scotland compared to the UK, while the rate of outflow rose, as in November, or remained broadly the same as that in the UK. This might superficially be taken as indicating that by the end of 1986 the benefits of increased training programmes and improved UK growth were affecting the general demand for labour in Scotland to some degree, but the downward effect on unemployment was more than offset by the inflow of redundancies due to the special circumstances that affected parts of the Scottish economy last year.

If there is any substance to this argument then we should expect increasingly favourable effects on the labour market and hence unemployment in Scotland but offset to some extent by the diminishing impact of last year's shocks. For these reasons the outlook for the Scottish economy and the labour market in Scotland is expected to be favourable over the coming months, but less so than that in the UK. Finally, it must be remembered that recovery in Scotland is starting from a much lower base than in the country as a whole; that the longer-run forces tending to increase regional imbalance in the UK should not be forgotten since the evidence shows that in acyclical upturn there is a narrowing of the imbalance around the long-run trend; and that the prospects for further growth in both Scotland and the UK depend crucially on what happens to the rate of inflation. There is still a long way to go.

18 May 1987