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Forty turbulent years: How the Fraser Economic Commentary recorded the evolution of the modern Scottish economy

Part 2: From recession to democratic renewal via privatisation and fading silicon dreams, 1991 – 2000

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Abstract

The recent economic history of Scotland, its performance and place within the UK and international economy can be traced through the pages of the Fraser of Allander Economic Commentary. Created in 1975 by a private bequest from Sir Hugh Fraser, a prominent Scottish businessman, the Fraser of Allander Institute has provided a continuous commentary on the economic and related policy issues facing Scotland over the period. In this the fortieth anniversary of the Fraser of Allander Institute, this is the second of three articles which chart Scotland’s transformation from an economy significantly based on manufacturing (and mining) to one that saw rapid deindustrialisation (in terms of output), the discovery of oil and the rapid transformation of its business base with the impact of both merger and acquisition (M&A) activity as well as the varied impacts of successive governments’ industrial and regional policies.

For the UK as a whole, the recession foreseen by Dr John Hall, TSB Scotland’s Treasury Economist, at the end of part one of this series, duly arrived. The Lawson boom of the late eighties had pushed inflation close to 10%. As chancellor, Nigel Lawson had tried to persuade Margaret Thatcher to take sterling into the European Exchange Rate Mechanism (ERM). All he managed was an informal shadowing, by value, of the Deutschmark. With the UK economy embarked on an unsustainable credit boom, interest rates hitting 15% and an inflationary wage spiral in full swing, it was left to Lawson’s successor as chancellor, John Major, to persuade an increasingly-beleaguered prime minister to formally join the ERM, in October 1990. However a day - or rather, days - of reckoning still beckoned. Thatcher herself was ousted by her own party within weeks, with Major taking her place. The ERM experiment lasted less than two years, sterling crashing out under speculative pressure, on Black Wednesday, September 16, 1992. With commendable Scottish understatement, the then-chancellor, Norman Lamont, confessed it had been a “difficult day”.

In the first Fraser of Allander Economic Commentary of 1991, editor Jim Love noted “As late as November the Government was still denying there would be a recession, despite the mounting evidence to the contrary. The GDP figures for the third quarter of 1990 and provisional figures for the fourth quarter removed any lingering doubt.” (Vol. 16, No. 3) In previous recessions, the Scottish economy had taken its full share - sometimes more - of the resultant pain. And this time one of the last remaining mainstays of Scottish heavy industry, the Ravenscraig steel works in North Lanarkshire, was already under threat. In May 1990 British Steel had announced its intention to close the hot strip mill at the plant.
in the first half of 1991. By the end of 1991 it went on to tell horrified Scottish ministers the rest of the complex, including its giant furnaces, would close too, in January 1992. Yet despite what was happening to Scotland’s biggest steel plant, Jim Love questioned whether this recession would hit Scotland as hard as the rest of the UK. While recent evidence did not “inspire much optimism”, there were reasons for believing any falls in output north of the border were “unlikely to be of the scale experienced in the UK as a whole”. Lower levels of borrowings by Scottish consumers left them more immune to high interest rates. Scotland had some export-intensive industries, like the burgeoning electronics sector in Silicon Glen, which were still enjoying growth in overseas demand. And the North Sea was going through a mini-boom in the wake of the first Gulf War.

Love’s contrarian prediction proved a shrewd one. For the UK as a whole the 1990/91 recession proved shallower than those of the mid-1970s and early 1980s. Overall, output contracted by 2.4% over five quarters and took twice that time to recover that loss in full. Yet, despite Ravenscraig’s fate, the Scottish economy barely contracted at all. Another manufacturing sector, that cluster of modern electronic assembly plants, collectively known as Silicon Glen, was booming. Between the first quarter of 1991 and the first quarter of 1998 its collective output tripled. In part that was down to growing capacity, as more American, Japanese and other overseas corporations were persuaded to invest in Scotland.

But Silicon Glen’s competitiveness in these new digital export markets was also helped by the sharp depreciation of sterling that followed the UK’s abrupt departure from the ERM. The Fraser commentary had sensed that prospect too. “One of the expected effects of ERM entry is to remove the ‘easy option’ of maintaining competitiveness by devaluation, and the government sees this as a means of imposing discipline on firms to keep costs - especially wage costs - down,” wrote its editor at the end of 1990. “Entering the ERM at a fairly high rate and at a time of rising unit labour costs was bound to put a great deal of pressure on manufacturing industry, particularly those sectors geared towards exports which are crucial to in providing an outlet for UK-produced goods at a time of faltering domestic demand. In the long-run the entry mid-point level of DM2.95 may prove unsustainable.” (Vol. 16, No. 2)

While Scotland’s economy, as a whole, emerged relatively unscathed from the early 1990s recession, its two biggest banks were not so fortunate. Injudicious lending at both the Royal Bank of Scotland and Bank of Scotland undermined profitability. Bank of Scotland had recorded pre-tax profits £194m in 1990. These fell sharply to £134m the following year before recovering marginally to £141m in 1992. In 1993 they fell again to £125m. Its larger rival, RBS initially took a much more serious hit. Profits of £262m at the start of the decade fell 78% to £58m in 1991 and collapsed a further 64% to just £21m in 1992. By 1993 RBS profits had rebounded to £265m. The Fraser commentary was alert to the dangers. “Fuelled by poor lending decisions and consequent bad debts, the banks have an urgent need to cut costs if they are to restore profitability. The bad debts, although severe, do not appear to threaten the existence of the companies at present but they must inevitably raise questions about how banking is organised in the UK.” (Vol. 18, No. 2)

Indeed RBS was already well embarked on an internal revolution in how it did business. George Mathewson, an expatriate engineer by training who had been running the Scottish Development Agency since 1981, had joined the Royal in October 1987 as director of strategy and development. By 1992, surrounded by a hand-picked group of former SDA colleagues he had taken with him, Mathewson was the Royal’s chief executive, implementing Project Columbus to root out the banking “dead wood” he
thought was clogging the Royal’s decision making. Over at Bank of Scotland another unconventional banker, Peter Burt, who had started his business life in the computer industry, was taking over the leadership role. By the end of the decade these two men would lock horns over which of their banks would acquire the English clearer NatWest. The first seeds of what would eventually become the biggest banking crisis in UK banking history were already being sown.

The SDA Mathewson left behind in 1987, to sort out RBS, was also approaching its political endgame. As we saw in Part 1, in 1988 Bill Hughes, a Scottish businessman with the ear of Margaret Thatcher, had proposed a much more balkanised model of economic development for Scotland, integrating skills training, stressing enterprise and innovation, and giving business people a much more powerful, localised voice in how the state helps grow an economy. Scottish Enterprise (SE), with its network of local enterprise companies (LECs), and its similarly configured northern counterpart, Highlands and Islands Enterprise (HIE), which replaced the even older Highlands and Islands Development Board, first opened their doors at the beginning of April 1991. The man recruited to head SE was an ex-patriate Scot from California’s Silicon Valley, a human resources specialist called Crawford Beveridge.

In the pages of the Fraser commentary, the advent of SE was greeted with plenty of healthy scepticism, notably from Neil Hood, Professor of Business Policy at Strathclyde Business School. (Vol. 16 Nos. 2 and 3) Hood was also an insider who had been Director of Locate in Scotland from 1987-89 and then Director of Employment and Special Initiatives, SDA during the run up to its merger with the Training Agency in Scotland and the launch of SE. He was concerned that, while in principle the SE core had been given a strong strategic role by ministers, the way its relationship with its network of 13 business-led LECs developed in practice could leave it “strong and powerful” or “weak and impotent”. That SE core, he argued, should continue to be recognised as “a national development agency in its own right”. Were it to become either a channel through which more localised funding and support was negotiated, or simply a facilitator of the work of the LECs, any strategic benefits from the reforms would soon be “frittered away”.

There were plenty of early tensions between the SE core and its LEC network. In another contribution to the commentary, Keith Hayton of Strathclyde’s Centre for Planning considered the local development pressures resulting from British Steel’s decision to close down its Ravenscraig site. Hayton cited one estimate of the funds needed by Lanarkshire Development Agency’s Chief Executive. It came to £650m spread over ten years! SE’s entire annual budget at the time was around £420m. “It is difficult to see funding on this scale being provided,” he observed. “A more likely scenario is that money will be diverted from the other LECs’ budgets. It may be that those LECs that have below average unemployment levels will be particularly at risk.” (Vol. 16, No. 3) The more prosaic reality is that, more than twenty years after the event, much of the Ravenscraig site has yet to be redeveloped.

Even in its formative years, under Crawford Beveridge’s leadership, Scottish Enterprise did manage to pursue some bold new national strategic goals. Swopping California for the west of Scotland, Beveridge quickly grew concerned about the relatively low rate of new business formation in his homeland, even compared with other parts of the UK. In 1993, at his instigation, SE launched its Business Birth Rate Strategy, designed to close that yawning enterprise gap. A whole suite of interventions were launched - from personal enterprise shows to new materials to support enterprise education in schools; new business network groups and funding forums; a higher education entrepreneurship programme and
mentoring support. The strategy had a target of helping create 25,000 new start-ups by the end of 1999. However when the Fraser of Allander Institute was commissioned to review the Strategy’s impact over those seven years, it estimated the number of additional start-ups achieved was just 2124. At a cost of some £20m a year, the strategy had eaten up some £140m. And over its life, Scotland’s business birth rate had actually fallen from 30.4 per 10,000 of the adult population (using VAT registration data) in 1993 to just 27.5 by 1999.

The political rationale behind creating Scottish Enterprise’s devolved, business-led structure was that it would deliver better Scottish solutions to distinctively Scottish problems. However even Conservative governments of the 1980s and early 1990s could not resist the lure of prestigious international projects that promised large numbers of skilled jobs. Health Care International, a £180m private hospital, built on derelict industrial land on the north bank of the River Clyde between Clydebank and Dalmuir, was the showpiece project of that type, when it opened in June 1994. The brainchild of two Boston-based doctors, Ray Levey and Angelo Eraklis, the 260-bed HCI offered advanced medical treatments to patients from southern Europe, North Africa and the Middle East. Costs would be met by their own health systems or out of their own pockets. The complex incorporated a four star hotel so that relatives could travel to Scotland to be with patients. The project had started under the old SDA which spent £7m clearing asbestos and other pollutants from the site. SE invested in the hospital, alongside its builder, John Laing, British Aerospace, an investment arm of Harvard University and a consortium of Dutch, French and UK banks (including Scotland’s RBS).

Less than three months after its official opening, at least one of HCI’s banks (IMG) was already very nervous. Only 400 of the promised 1800 jobs had been created. Patient numbers had fallen even more dramatically behind forecasts. Peak bed occupancy at that stage barely topped twenty. The Scottish Office and the Bank of England cracked the whip and support payments, from public sources and from the banking consortium, were accelerated. But to no avail. By November 1994 HCI had called in the receivers. In early 1995, the assets were acquired by the London-based Abu Dhabi Investment Company and the hospital relaunched with fresh investment and a plan to treat a steady stream of patients from the Emirate. But even this intervention, involving a son of Abu Dhabi’s crown prince, did not resolve HCI’s destiny. Increasingly it was used to treat urgent NHS cases from across the UK. In 2002 it was acquired outright by NHS Scotland to help address lengthening waiting times and is now the Golden Jubilee National Hospital, specialising in heart and lung treatments, but also carrying out a significant proportion on orthopaedic procedures for NHS patients from across Scotland.

What happened to HCI in the 1990s - a state-supported private health care initiative being turned on its head, through abject market failure, into much-needed additional capacity for Scotland’s domestic state- provided health service - ran completely counter to what successive Conservative governments thought they were about at that time. Privatisation of state assets and utilities was one of the defining drivers of the Thatcher and Major years. British Telecom and British Gas were sold to the public in 1984 and 1986 respectively. British Airways and water supply, in England and Wales, were disposed of too. While the HCI hospital was being built it was still full steam ahead on privatisation. In 1991 the Scottish Bus Group was privatised. At the beginning of 1993, the process of breaking British Rail up started, replacing it with a track, signals and stations operator; a series of privatised regional train operating companies, including
ScotRail; and three rolling stock leasing companies. the first of these three groups, Railtrack, was effectively renationalised after the Hatfield Rail Crash in 2000 and is now Network Rail.

In 1991 along with the rest of the UK electricity supply industry, shares in Scotland’s electricity suppliers were offered to the public. However there was room for a specifically Scottish solution for those parts of the network operating north of Hadrian’s Wall. Both the South of Scotland Electricity Board (SSEB) and the North of Scotland Hydro-Electric Board were privatised as vertically-integrated businesses - Scottish Power and Scottish Hydro-Electric respectively - controlling everything from generation and transmission to distribution and supply in their designated areas. Only SSEB’s nuclear assets were ring-fenced from the sale, later to be merged into British Energy and sold to the French utility EDF. In England and Wales the old Central Electricity Generating Board was broken up into four - a National Grid company, responsible for the entire high voltage transmission system south of the border and three electricity generators, National Power, Powergen and Nuclear Electric (later British Energy). In addition twelve regional electricity companies were created, responsible for distribution and supply in their areas.

Even before the privatisation process was complete, the commentary was noting (Vol. 15, No.4 and Vol. 16, No.1) that both Scottish companies had much to gain by exporting more of their excess power south and exploring new collaborative generating opportunities and commercial supply deals there too. As the post-privatisation environment matured, both Scottish companies exploited their integrated structure to acquire regional supply companies over the border and develop their generating capacity there too. Hydro-Electric, now SSE, after its 1998 merger with Southern Electric, remains a listed company, headquartered in Perth. Scottish Power was acquired by the Spanish group Iberdrola in 2007. Like all their main competitors, SSE and ScottishPower now supply gas as well as electricity. Today, of the six biggest players, two are German-owned, one French and one Spanish. Only SSE and British Gas (owned by Centrica) remain in UK ownership.

What happened to the electricity sector through privatisation has left one competitive wrinkle, causing tensions to this day. National Grid still owns the high-voltage network south of the border. Under BETTA (the British Electricity Trading and Transmission Arrangements), it is also the system operator for the entire UK-wide high-voltage grid. In effect it regulates flows of electricity around the whole UK and the terms under which these flows take place. However National Grid is a major commercial player in that market, just like SSE and Spanish-owned Scottish Power, who still own and operate their own parts of the high-voltage wires in Scotland. So when it comes to moving away from fossil fuel generation towards greener forms of generation (most notably onshore wind) there is growing political tension.

Scotland wants to export as much green electricity south as it can. But its own baseload generating capacity is diminishing, now that Scottish Power is closing its massive coal-fired Longannet station next March. And no one, not even Scottish Power or SSE, seems interested in building new base-load capacity north of the border. The SNP-controlled devolved Scottish government has an embargo on any new nuclear generating capacity here too. And now the new majority Conservative government at Westminster is talking about cutting back on subsidies for renewable generators, like onshore wind farms. The future of BETTA, which the SNP, in its 2014 Scotland’s Future white paper, said it would continue to support, were Scotland to vote yes to independence, looks like becoming a growing source of political friction between Edinburgh and London over the next few years.
While the final decade of the 20th century was marked, right across the UK, by a very significant re-drawing of the boundaries between what the state could best provide and what should be vested in market competition, it was also a time of significant political and constitutional upheaval, especially in Scotland. In 1994 the Major government legislated to abolish the two-tier structure of regions and districts across Scotland, introduced in the 1970s, and replace them with 32 unitary authorities. When the new Act came into force in 1995, the vast Strathclyde Region, centred on the City of Glasgow and the Clyde estuary, was no more. Water and sewerage services were taken away from local democratic control. However in the wake of a political campaign which included a ‘water referendum’ organised by Strathclyde Region, the Conservative government baulked at privatising these services the way it had in England and Wales. Instead three public water and sewerage authorities were created, covering the west, east and north of the country. In 2002 these would be merged into a single body, Scottish Water, created by an act of the new devolved Scottish parliament.

Against all the predicted odds, the Major government had retained power in the 1992 UK general election. That gave it a mandate to continue to pursue its wide-ranging programme of privatisation and advance the wholesale restructuring of the architecture of the British state. But as the next general election loomed, in 1997, there were growing signs that eighteen years of Tory rule were coming to an end. The choice facing voters was particularly acute in Scotland, where the Labour opposition, now under Tony Blair’s leadership, was committed to holding another referendum on Scottish home rule and - if it proved to be the settled will of the Scottish people - the creation of a devolved Scottish parliament in Edinburgh for the first time since the Act of Union in 1707.

A month before the 1992 general election, the Scottish Office published, for the very first time, what its press release of the time rather prosaically called a “booklet” on Government Expenditure and Revenues in Scotland. “In reading this booklet, the people of Scotland will be able to judge for themselves the extent to which Scotland derives economic benefit from being a part of the United Kingdom,” explained Ian Lang, the Secretary of State for Scotland at the time. That first booklet showed total public expenditure per head in Scotland just over 12% higher than in the UK as a whole, and identifiable general government expenditure 19% higher than its UK equivalent and 24% higher than in England. On the revenue side, over the four main classes of revenue raised in Scotland - income tax, national insurance, VAT and local authority revenue - Scotland’s contribution was below its population share. “In short,” claimed Lang, “we contribute less than our population share to the UK Exchequer, and receive more from it.”

That analysis, now known universally by its acronym GERS, has appeared annually ever since. It has been refined. Since the start it has been the work of Scottish civil servants. It has proved contentious and sometimes inflammatory fuel for the ongoing political debate about Scotland’s constitutional future. A strong flavour of that controversy is evident in three linked pieces which appeared in the Fraser commentary in 1997 (Vol. 22, No. 3). The first is a comment on the SNP Budget for Scotland by the Institute’s Jim Stevens. The second is a riposte by Andrew Wilson, an economist, speaking for the SNP, later a list MSP for the party in the very first Scottish devolved parliament. The final piece is an analysis of the SNP budget, which formed part of the party’s manifesto for the 1997 UK general election, by Peter Wood, of the independent Scottish consultancy group Pieda. Intriguingly the pieces only appeared in the June edition of the commentary, six weeks after the votes cast on May 1 had been counted and Labour
had swept to power with a 179-seat majority. The SNP had doubled its Scottish seats tally from three to six.

Stevens based some of his analysis on the latest GERS figures. He rejected the charge that, by doing so, he was accepting “Tory fiddled figures”. That was a “puerile slur on the professional integrity of government economists”. The SNP’s view of our fiscal prospects, Stevens concluded, was “ludicrously optimistic and fatally flawed”. Oil revenues would endure for a long time “but on a declining trend and would not be sufficient to ensure that we did not have to borrow more or tax more to enjoy the same level of public services that we would have enjoyed inside the Union.” If we are to opt for independence, he went on, “It will not be an easy ride and we should only do so with our eyes wide open. Suspect and inaccurate appraisals of our fiscal prospects are about as much use in the Scottish constitutional debate .... as a chocolate fireguard.”

Wilson’s response, on behalf of the SNP, didn’t pull any punches either. He opened by recalling that, in 1970, David Simpson and Kenneth Alexander had contributed essays to an OUP book, respectively for and against the economic case for Scottish independence. Simpson was the founder director of the FAI and Alexander professor of economics at Strathclyde. Alexander was, Wilson quipped, in “the grey corner” while Simpson occupied “the sunshine corner”. Clearly the gloves were off. Scotland’s inherited fiscal position on independence, Wilson argued, “is of less importance to the economics of independence than the dynamics. It is not the starting point but what happens through time that is of greater importance.” If an independent government proved better for the Scottish economy than London government, delivering faster growth and releasing latent enterprise, then any initial fiscal deficit would quickly diminish. Stevens’s contribution to the debate was “welcome”. But it contained “unsustainable arguments couched in pejorative language.’

It was left to Peter Wood of Pieda to offer a view from outside the ring. “Few, if any, economists would dispute that Scotland would be economically viable as an independent country,” he observed. “It is quite evident that Scotland’s economy is larger, more prosperous and more soundly based than many existing independent states. However there is much less agreement as to whether an independent Scotland would be more or less prosperous than a Scotland which remained within the UK.” He went on to point out that the budget the SNP proposed involved spending increases that, by 2001, would push Scotland’s budget deficit to almost £7bn, or nearly 10% of GDP. “With some determined belt tightening in terms of reduced public spending and/or tax increases” an independent Scotland could reach the Maastricht criteria for joining European Monetary Union. Whether it might become another Celtic Tiger in the longer term was, Wood judged, “far less certain”. And the idea that independence would deliver an instant public spending bonus he dismissed as “untenable”.

The really striking thing about these exchanges, reading them again now in 2015, is how little has been resolved in this core economic argument about Scotland’s constitutional future over the eighteen years since they took place. Next year the devolved Scottish parliament and government will complete its fourth full term. We have had a referendum on Scottish independence where the yes side lost by a margin of more than ten percentage points. We have had another UK general election in which the SNP swept the board in Scotland in unprecedented fashion. The Smith Commission proposals have led to another Scotland Bill, offering more devolved fiscal powers to Edinburgh, currently being debated at Westminster. But, in tone, texture and temper, the economic arguments for and against further
constitutional change seem as entrenched and unresolved as ever they were. Even debates about the prospect of something short of outright independence - full fiscal autonomy within the existing Union - suffers from the same statistical trench warfare.

In the final years of the old century, constitutional preoccupations were more about whether Scotland would vote for the new devolved parliament Labour had promised and whether Scots would also vote to give that parliament modest powers over tax. Labour, led by Tony Blair, won its huge 1997 majority in part on a pledge of strict fiscal rectitude. Blair’s chancellor, Gordon Brown, would stick, for their first two years in office, with the same tight spending plans already set by the outgoing Tory administration. Even Brown’s Treasury predecessor, Ken Clarke, later admitted he didn’t really think his party could have delivered on those legacy spending plans had they won. But Brown stuck with Clarke’s shirt. In each of its first three years in office, New Labour generated increasingly large budget surpluses, thanks to that squeeze on public spending. Such budget surpluses had only happened in four other years since the mid-sixties. For the vast majority of the past half century, annual budget deficits have been the norm in the UK whoever was in power. Against that backdrop, it is no surprise that the modest fiscal powers vested in the new parliament in Edinburgh in 1999 - to vary the basic rate of income tax up or down by up to three pence in the pound - has withered unused on the fiscal vine ever since.

As the new millennium approached, did that tight squeeze on public spending have any significant impact on the real economy on terms of output and jobs? As we have seen, the 1990s had started with the Scottish economy narrowly escaping the recession that hit the rest of the UK. At the start of the decade unemployment, in both Scotland and the UK as a whole, had been on a downward trend for nearly three years. The Scottish jobless rate, while not as far adrift as it had been at the end of the 1970s, was still a full three percentage points higher than the UK equivalent. However that gap narrowed when the recession was felt more keenly south of the border. Scotland’s unemployment rate even dipped below the UK rate in 1992/3 and stayed much the same until the middle of the decade. Then it began to drift higher again.

Two contrasting forces were at work. Scotland’s push to attract more electronics assembly plants to its shores appeared, for much of the decade, to be paying dividends. Successive Fraser commentaries charted the way output from Scottish manufacturing plants caught up with equivalent UK output by late 1994, then to soar higher right through to the end of the decade. There’s a chart on page 7 of the January 2000 edition (Vol. 25, No. 1) that captures that clear trend. However New Labour’s squeeze on public spending was also having its impact, in sectors where the Scottish economy was already more dependent, in employment terms, than its southern counterpart. On top of that, there were already clear signs, despite that soaring manufacturing output, that the silicon dreams fostered in Scotland through the 1980s and 1990s might be beginning to fade.

Motorola had built a massive complex to assemble mobile phones at Bathgate which opened in 1990 and employed more than 3000 people. By 2001 it was closing down and shipping the assembly work off to cheaper host economies in eastern Europe. In 1996 the Taiwanese group Chungwa arrived at Mossend in Lanarkshire promising even more jobs, 3300, assembling cathode ray tubes. But that was yesterday’s technology. The advent of flat screens changed all that and Chungwa was gone in six years. The Korean group Hyundai agreed to come to Fife to fabricate silicon chips. A hugely expensive wafer fab was built, with lots of support from Scottish Enterprise and government. But Hyundai changed
its mind. And with other established wafer fabs, like the Japanese group NEC’s plant at Livingston, also closing. the Fife site never produced a single wafer. It has since been demolished.

The Outlook and Appraisal in the last Fraser commentary of 2000 (Vol. 25, No. 4) caught the mood. “The Scottish economy experienced a further contraction in output in the first quarter of the year. Growth was considerably weaker than in the UK,” it noted. “The service sector exhibited no growth, while manufacturing output fell markedly..... the fall in electronics output appears to be a key reason for the overall weakness.” Some in the Scottish media were already talking of another recession. The Fraser team disagreed. But with trouble in Silicon Glen, a stronger pound hitting exports and growth in public expenditure tightly constrained, the new century was starting on an uncertain note. In the final part of this series we will bring this story up to date.

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