

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

Part 3: The 'Nice' decade turns nasty; banking Armageddon; and the politics of austerity, 2001 – 2015

Alf Young

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 last 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 employment, less so 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.

At the end of part 2 of this series we noted that Scotland's hopes of replacing its old core industries of shipbuilding and steel with a renaissance based on microelectronics was already beginning to fade. The largely American and South East Asian-owned plants fabricating processing chips and assembling computers and mobile phones, having turned large parts of central Scotland into Silicon Glen, were either transferring production to lower-cost locations or failing to deliver promised investments at all. In the first Fraser commentary of 2001 Richard Marsh considered the consequences. "The development of an electronics sector within Scotland was intended to increase job security, opportunities and value added within the economy," he wrote. "The sector's downturn is therefore bad news for Scotland's growth. This then begs the questions what are the underlying forces causing the recent developments and do they spell the end for Silicon Glen?" (Vol.26, No.2). Marsh suggested exploiting established linkages and upgrading Scotland's skills base might help underpin a smaller, smarter electronics cluster. In 2002 total exports from Scotland of computer, electronic and optical goods were worth nearly £5.6bn. By the end of that decade Silicon Glen exports had halved and halved again, to just under £1.4bn.

While Scotland's ambition to punch above its weight in this new digital world was facing setbacks, a much more traditional sector of its economy was embarking on a period of unprecedented export-led expansion. In the decade from 2004, sales of Scotch whisky to some 200 markets around the world grew by 74%. Over the same period, sales of single malts surged by 159%. In the 1980s the sector had been convulsed by takeovers, notably by Guinness, of Fells, then Distillers. In the 1990s, as a result of over-production and too much Scotch being sold in bulk to overseas competitors, distillery capacity was

being mothballed. Now Scotch vies to be Scotland's biggest single export by value. Right through to the present some mothballed distilleries are being reopened, some working distilleries are having their capacity expanded, new ones are being built, and others planned. Scotch whisky now accounts for a quarter of all UK food and drink exports. Annual visitor numbers to distilleries have topped a million and a half, boosting Scotland's tourist trade.

Oil was first discovered off Scotland's shores when the first Fraser commentary was still in gestation. North Sea production peaked at the end of the 1990s. In early 1998 the price of Brent benchmark oil was heading down towards just \$10 a barrel. Ten years later the price peaked at over \$140 a barrel. Within a year, thanks to the great recession brought on by the banking crisis of 2007/08, that oil price had fallen back below \$40 again. It recovered again to just over \$120 by 2011 and, as Grant Allan shows in a recent Fraser commentary (Vol.38, No.3) then fluctuated in a band of \$100 to \$120, until late 2014 when the price rapidly collapsed to below \$50 again. Government tax revenues from offshore oil and gas production first peak in the early 1980s, spiking again in 2008 and again in 2011 when oil prices were high. The falls since late last year mean tax revenues have all but evaporated. Since the North Sea has been historically a high-cost province, one now moving steadily into maturity, with development plans being curtailed and staff losing their jobs in significant numbers, the future looks more and more uncertain. Oil price volatility now threatens significant consequences for Aberdeen, Scotland's oil capital, but for a supply chain that stretched down into central Scotland and much further afield in the UK.

Volatility was also a major factor in the eclipse of Silicon Glen in the early 2000s. One of the underlying forces at work there was the speculative dot-com asset bubble which afflicted the American NASDAQ stock market index in the final years of the old century into the dawn of the new millennium. Its tech-heavy composite index, which stood around 100 when the Fraser Commentary first launched in 1975, broke through 1000 in July 1995. Then, fuelled by what US Federal Reserve chairman Alan Greenspan, in a speech in December 1996, called "irrational exuberance", the index rocketed. Those betting that the emergence of the world-wide web would be far more transformational for the global economy than any previous industrial revolution, could not get enough of the new internet-based companies heading to NASDAQ, some with brazenly overblown IPOs. Its composite index peaked at an intra-day high of 5132 on March 10, 2000. The collapse that followed was even more precipitous. It plunged back near where it started, to an intra-day low of 1108, in September 2002. Amazon saw its stock slashed from \$107 a share to just \$7. It took the NASDAQ index another thirteen years, until April 2015, to recover and surpass that millennial pre-burst peak. Many of its beneficiaries did not survive the burst. Some, like Bernie Ebbers of WorldCom, went to jail for securities fraud and conspiracy. Ebbers is currently serving 25 years. For some who successfully rode out the rollercoaster, it's been a very different story. Amazon's stock is now touching \$600 a share.

Another traumatic set of events on American soil, which erupted on an unsuspecting world while the hot air was still spilling out of the dot-com bubble, was to have geopolitical consequences that have also helped shape our collective destiny ever since. Of the four US domestic flights hijacked on the morning of September 11, 2001 by 19 al-Qaeda terrorists, two were flown into the twin towers of the World Trade Centre in New York's Lower Manhattan district, one was flown into the west side of the Pentagon in Washington and the fourth, after resistance by civilian passengers, crashed into a field near Shanksville, Pennsylvania. In all 2,996 people died. One early instinct was to try and quantify the impact of 9/11 on

the global economy. Three months after the twin towers fell, that December's Fraser commentary described that impact as "difficult if not impossible to quantify". Scotland could expect reduced tourism demand, lower exports outside the UK, and a reduction in inward investment. The commentary agreed with the view of the then chief economic advisor to the devolved Scottish government, Dr. Andrew Goudie, that Scotland's annual growth "will decelerate but should remain positive". The Fraser team cut its forecast for 2002 GDP growth from 1.4%, but only down to 1.2% (Vol. 26, No. 4).

US and British forces had started aerial bombardments of Taliban and al-Qaeda targets in Afghanistan within a month of the mass slaughter in New York. Special forces, on the ground in Afghanistan, had already overthrown Taliban rule by the time the December commentary appeared. The Allied invasion of Iraq in March 2003 and the subsequent overthrow of Saddam Hussein were to follow. While winning the war in Iraq and managing some sort of peace in Afghanistan were to dominate the strategic thinking of Western governments throughout the first decade of the 21st century, by 2011 we had the multi-state intervention in Libya in 2011 and, by 2014, the rise of ISIS in parts of Iraq and Syria, and the growing exodus of refugees now risking all to find a new life within the EU. Even Tony Blair now concedes "elements of truth" in the claim that the war in Iraq helped cause the rise of Islamic State. However myopia at the highest levels of western government about the long-term consequences of the geopolitical choices made in the immediate aftermath of 9/11 is mirrored in some of the key choices made by central bankers during and after the dot-com bubble.

US Fed chairman Alan Greenspan had certainly warned of the consequences of irrational exuberance in financial markets back in 1996. But he and his colleagues were slow to do anything, by way of monetary policy, to take the steam out of the mounting market hysteria. Over the five years between July 1995 and March 2000, while the NASDAQ composite index was rising more than fivefold (from 1000 to 5132), the Fed changed its main interest rate eleven times. But to little effect. It stood at 5.75% in July 1995. It was just a notch higher, at 6%, in March 2000. When the tech bubble burst, and with the wider US economy showing signs of increasing fragility, Greenspan and the Fed's open market committee suddenly became much more proactive. They cut the federal funds rate eleven times in 2001 alone. All the way down from 6% to 1.75%. Four of those cuts (1.75 percentage points in total) came in the shocking wake of 9/11. There were two further cuts, one each in 2002 and 2003, taking the main interest rate all the way down to 1% where it stayed for a further year. With rates that low for that long, another asset bubble was already in the making.

This time it was housing. With borrowing now so affordable who across America could not aspire to own their own home? The sub-prime mortgage scandal, which was to become such a central factor in the banking meltdown later in the decade, was already beginning to take shape. Greenspan has always denied he and the Fed were to blame. "Those who argue you can incrementally increase interest rates to defuse bubbles ought to try it sometime," he said in 2008. "I don't know of a single example of when interest rate policy has been successful in suppressing gains in asset prices." The former chief economist of the IMF, Kenneth Rogoff, disagreed. "If you cut interest rates when asset prices are in free fall, then when asset prices are rising while indebtedness is rising all over the country, you need to raise rates. He (Greenspan) actively chose not to do that."

Greenspan was not the only central banker taking a distinctly relaxed view of the emerging economic and geopolitical threats of the period. In October 2003, Mervyn King, just three months into his term as

Governor of the Bank of England, delivered an intriguing speech in Leicester. Since the end of the Second World War, he suggested, Britain had experienced a succession of stop-go, boom-bust cycles. However the ten years from the 2nd quarter of 1992 had been, he ventured, the nice decade. The UK had experienced a Non-Inflationary, Consistently Expansionary ten years. NICE, if you can get it. A decade in which growth was above trend (2.9% compared with the post-war average of 2.5%). Inflation, having been targeted from late 1992, had averaged 2.5%, the lowest for a generation. Unemployment had fallen from 10% to 3%, the lowest level for three decades. Output had risen in every single quarter. Living standards were rising as the terms of trade moved in Britain's favour.

The new governor put the success of the 1990s down to a number of things. One was the new monetary framework, introduced by the first Blair government in 1997, that gave the Bank of England independence and a clear inflation target. Another was "a sustainable fiscal consolidation that had turned a deficit of 8% in 1993 into a sustainable position for the public finances based on a set of clear rules for government debt". King was referring to the striking consequences of Gordon Brown, as the new Labour chancellor, adopting the tough spending targets of his Conservative predecessor, Kenneth Clarke. Since 1965 there have only been seven years when UK governments have not had to resort to net borrowing to fund their spending promises in full. Two occurred between 1969 and 1971, the last year of Harold Wilson, the first of Ted Heath. Another two at the tail end of the Thatcher era in the late 1980s. And the other three were at the end of the 1990s, when the New Labour government walked into Downing Street for the first time and Brown immediately donned Clarke's hair shirt.

King did not deny there had been some "unexpected twists and turns of the world economy ... especially in the latter half of (his nice) decade". However, he argued, "those shocks tended to average out over time rather than cumulate in either an upward or downward spiral. In other words the economic surprises alternated between good one year and bad the next rather than adding up to 'one damn thing after another'. In that sense, Lady Luck smiled on us." Would the next ten years be as nice? was King's rhetorical teaser. The new governor judged that "unlikely". However he insisted that realistic conclusion was not "a case for pessimism, rather the opposite". He judged the macroeconomic framework in the UK "sound and proven". From such a "new-found position of macroeconomic stability" there was now an opportunity "to boost productivity, education and enterprise in order to generate the resources needed to raise living standards".

The Bank of England's governor was not alone in detecting more benign economic times. In February 2004, in a speech in Washington, the man who two years later would succeed Greenspan as chairman of the US Federal Reserve was saying something very similar. Ben Bernanke noted that the previous twenty years had seen a sharp decline in macroeconomic volatility in the US. Variability of quarterly real output growth was down by a half since the mid-1980s. Variability in inflation down by two thirds. Bernanke called it the Great Moderation. He cited three reasons for it. Structural changes in the economy, including much wider use of information technology, which improved the economy's capacity to absorb shocks. Improved macroeconomic policies, notably control of monetary policy moving from politicians to central bankers. And that magic ingredient - Lady Luck - again. However these improved policies were still fallible. And all that luck was about to run out.

Before we discover why luck did run out, we should consider what impact changes in the way Scotland would now be governed were having on the evolution of the Scottish economy. The first devolved

Scottish government came into being in 1999, a Labour/Liberal Democrat coalition led by First Minister Donald Dewar. In June 2000 it produced what it called “a step change in economic policy making in Scotland”. Its Framework for Economic Development was 92 pages of principles and priorities, enabling and outcome objectives, even a vision. It was “to raise the quality of life of the Scottish people through increasing economic opportunities for all on a socially and environmentally sustainable basis”. Words that would still not seem out of place in political debate on economic ambitions today. That they still seem so familiar fifteen years on suggests delivery is an altogether tougher nut to crack than trading visions. The Framework called for “the enhancement of productivity”. So did the current UK chancellor George Osborne in his most recent budget. In one Commentary piece in June 2005, after the Scottish government launched a refresh of its Framework document, Peter Wood asked heretically “Is the growth of the Scottish economy the first priority for public spending in Scotland?” (Vol.30, No.1)

That first devolved coalition inherited the enterprise agencies, Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE), created in the Bill Hughes-inspired reforms of 1991. They are still with us today. Their inward investment arm Locate in Scotland was, in 2001, turned into Scottish Development International, charged with both attracting overseas investment to Scotland and encouraging Scottish companies to export more. The skills work previously carried out by Careers Scotland was folded into SE and HIE only to be hived off again in a new agency Skills Development Scotland in 2006. The year before SE and HIE were stripped of their networks of local enterprise companies (LECs). The Business Gateway Network was hived off to local authorities. Three self-standing Intermediate Technology Institutes (ITIs) were set up by SE in 2004 to find and develop innovative technology in the fields of techmedia, life sciences and energy, with a budget of £450m over ten years. The ITIs were absorbed back into SE in 2009, having spent £231m but with very modest returns to show for it.

A “bold” initiative, SE’s current chief executive Lena Wilson told MSPs in 2013, had fallen victim to an economy that had not turned out as the agency had thought. Both SE and HIE have survived the change of control of the devolved Scottish government, to a minority SNP administration in 2007 and then an outright SNP majority in 2011. Their budgets have reduced in real terms over a number of years and perhaps their influence too. Both Alex Salmond and his successor as first minister, Nicola Sturgeon, have chosen to appoint their own Council of Economic Advisers whom they meet twice a year. The core of both SE and HIE’s activity now is to run a system of account managed businesses, some 2500 in total, which are assessed as having real growth potential. But that, they are at pains to argue, does not preclude them doing a lot of support work with other businesses that are not account managed. One enduring mystery is why, given the failure of the ITI initiative, there is not more independent scrutiny of what the account management system is actually achieving.

The first decade of the new millennium did not quite match the 1980s in the range and scale of Scottish companies facing corporate takeover. Acquisition activity was, however, on the rise again. In 2002 the Mersey-based Peel Group acquired Clydeport. The following year the American newspaper group, Gannett, acquired the Glasgow-based Herald and Times from STV-owner SMG. In 2005 Scottish Radio Holdings was sold to Emap. In 2007 the Spanish group Iberdrola acquired ScottishPower. And in 2008 the French, largely state-owned, electricity generator, EDF, acquired British Energy, including its Torness and Hunterston B nuclear stations. From the late 1990s onwards almost all of Scotland’s mutual life insurance and pensions groups surrendered control to bigger English or continental based players.

Only Standard Life, which demutualised in 2006, bucked the trend by seeking a full market listing in its own right.

However, as we noted briefly in Part 2 of this series, the takeovers that were to dominate both the Scottish and UK economies as the new century began were the attempts by Scotland's two oldest banks, Bank of Scotland and Royal Bank of Scotland (RBS), to turn predator not prey, in the takeover game. Bank of Scotland was first to act, spurred on by Standard Life's surprise decision in 1996 to sell its one-third share in the Bank, acquired a decade earlier from Barclays. BoS, having celebrated its 300th birthday the year before, suddenly discovered a sense of vulnerability. Once Standard Life was persuaded to dispose of its stake piecemeal in the market, the Bank's Governor Sir Bruce Pattullo and chief executive Peter Burt set out to find a merger partner among the bigger UK building societies, then abandoning their traditional mutual status. That trawl proved fruitless. After Pattullo retired, Burt persuaded his board on a much bolder strategy. The Bank should launch a hostile bid for NatWest, twice the size of BoS but the poorest performer among the big four English clearers.

At first Burt tried to persuade his opposite number at RBS, Sir George Mathewson, to mount a joint bid. That would bring much more financial firepower to bear and, if successful, would allow them to split the spoils between them. However it quickly became clear both Scottish banks would want the same parts of NatWest. The talks foundered. Then in September 1999 the intended prey announced an agreed deal to buy the giant insurer Legal & General for £10.7bn. If that deal went through, the price tag on an enlarged NatWest would be way beyond what the smaller Bank of Scotland could afford. It was decision time. Would it bid or walk away? The Bank's acting chairman Sir Jack Shaw broke the news of its hostile bid in a dawn phone call to NatWest's chairman Sir David Rowland on Friday September 24 1999. The timing was exquisite. Most other senior bankers, including RBS's Mathewson, were already in America for the annual meetings of the IMF and the World Bank.

Burt won lots of plaudits for the logic of the Bank's bid. It certainly killed off NatWest's deal with Legal & General. However, as is usually the case in hostile offers, pressure was on from the City to discover how much more BoS would be prepared to pay. It did raise its terms once but, with NatWest's share price rising faster than its own, closure was proving elusive. The Bank improved its terms. However the relative share prices of predator and prey pointed to the City expecting even more. Meanwhile, with Mathewson quickly back in the UK, RBS was planning its own counter-bid for NatWest. That came on the 29th November, with the Spanish bank BSHC (now Santander), then a shareholder in RBS, willing to provide some of the cash. It was made clear that RBS's then chairman Lord Younger would retire to be replaced by Mathewson. His deputy Fred Goodwin would mastermind the integration of NatWest and succeed Mathewson as chief executive to drive the combined bank forward. On the 11th of February 2000 RBS's offer was accepted by NatWest.

A shell-shocked Bank of Scotland was forced to confront its own vulnerabilities once more. Tentative merger talks with National Australia Bank and Abbey National followed. Then, little more than a year after NatWest slipped through its fingers, Bank of Scotland agreed to merge with the biggest mortgage lender in the UK, Halifax. While the headquarters of the combined bank - Halifax Bank of Scotland or HBOS - would be in Edinburgh, most of the main jobs - chairman, chief executive, finance director, head of retail and head of insurance - went to Halifax men. Burt stayed on briefly as executive deputy chairman, then retired. He had vastly more banking experience than the Halifax five had among them.

Not that the Bank's Scottish rival, RBS, was any different in that regard. Mathewson had been first an engineer, then venture capitalist and had run the SDA before he joined RBS. And his successor, lawyer-turned-accountant Goodwin's first banking job was as chief executive of Clydesdale Bank for three years.

That didn't stop any of them from trying to build market scale in the sector that was really booming on both sides of the Atlantic, thanks to cheap money and all that central bankers' talk of a new era of macroeconomic stability. That sector was housing and the wider property market. Buoyed by capturing NatWest, Goodwin embarked on what began to look like a growth at any cost strategy. RBS kept buying more banks, many of them in the US as bolt-ons to its own existing Citizens Financial, a Rhode Island-based savings and loans bank with a big exposure to housing finance. That process led, in 2004, to paying an eye-watering \$11bn for Charter One banking group, a launch pad into the American mid west. In Ireland, where another property bubble was rapidly inflating, Goodwin urged Ulster Bank, operational right across the island of Ireland and acquired as one of the NatWest spoils, to maximise its loan book. Between 2000 and 2007, Ulster Bank grew its total assets (effectively its loan book) six-fold to €55bn! Goodwin also bought a newer mortgage bank, First Active, because he wanted the man who created it to run Ulster Bank as well. A major strand of Goodwin's ambition for RBS was to turn it into a globally significant investment bank. Another of the NatWest spoils, Greenwich Capital in Connecticut, became one of the biggest players in the underwriting in securitised packages of mortgages, many of them sub-prime, traded on as investment opportunities.

HBOS was also going flat-out to exploit the growing housing bubble. Remember Howard, the singing bank clerk who starred on the bank's TV adverts. He reportedly bought an £800,000 second home with one of the bank's mortgages. I once asked Andy Hornby, the former ASDA executive who was HBOS chief executive James Crosby's right-hand man whether he ever worried the housing bubble was getting out of hand. "It's a simple question of supply and demand," he replied. "Demand for housing vastly outstrips supply. There's absolutely no evidence that's coming to an end." Corporate banking in HBOS was the really distinctive strand Bank of Scotland brought to the merger. BoS corporate bankers had always fancied themselves as more entrepreneurial in the way they did business. Little wonder then that as commercial property deals boomed, they grabbed more than their share and, in the process, became more and more exposed to the fate of bricks and mortar in the longer term.

As the decade rolled on, investors were growing more and more restless about Fred Goodwin's seemingly insatiable appetite for serial deal making. They had noted that despite all the frenetic activity, Royal's share price, having peaked in 2002 around £21, had been becalmed for two years in the £15/£16 range. In 2005, under pressure from some on his own board, RBS's chief executive began publicly to dismiss any need for the bank to keep on making more acquisitions. But he was already preparing the next deal. A 5% stake in Bank of China. Then came the biggest deal of all - the hostile consortium bid Goodwin put together with Banco Santander and Belgian bank Fortis to snatch the Dutch banking group ABN Amro from under the nose of Barclays. The idea first captured Goodwin's imagination in 2005 and dominated his thinking for most of 2006 and 2007. The big prize for him was ABN Amro's American subsidiary LaSalle. But the Dutch bank sold it to Bank of America early in the proceedings. Quite how a generous, largely-cash bid for a bank with operations in 53 countries, operations that would then be split three ways among the consortium partners, made any sense in an

environment where property risks were crystallising and banks in general were under growing pressure, is anyone's guess. But RBS shareholders voted for it and Scotland's new first minister Alex Salmond publicly led the home cheer-leading. Bear Stearns and Northern Rock were already going under as the Royal Bank of Scotland ABN Amro saga was reaching its catastrophic conclusion.

Within a year, with the credit squeeze tightening, interbank lending slowing to a trickle and yawning property black holes opening up in bank balance sheets, Armageddon loomed. In America Lehman Brothers filed for Chapter 11. In the UK, with the cash literally running out, HBOS was shepherded, with government and Bank of England encouragement, into the arms of Lloyds TSB, with the state the dominant minority shareholder in the combined group. RBS was also kept alive, just. But with the state as the dominant shareholder with more than 80% of the shares. The Fraser commentary spoke for many about how far the Scottish banks had fallen below the historic standards they had set themselves. "The scale of the losses on sub-prime and impairments facing the two principal Scottish banks, RBS and HBOS, are considerable and exceptional compared to other UK banks. The losses have pushed RBS and HBOS to the brink of bankruptcy. This outcome underlines the extent to which the lending behaviour of the two banks had ceased to be underpinned by the traditional risk management practices that had led Scottish banking and bankers to be perceived as prudent and even canny." On its worst-case scenario there would be a period of sustained recession. "Here the seizure of the financial system continues for an extended period, bank illiquidity persists, leading continues to be severely constrained, and confidence remains low. A greater contraction in household and investment demand follows, leading to negative growth for two consecutive years." (Vol. 32, No. 2)

Being an economic commentary, the Fraser tended to play down the political consequences of the great banking crash of 2008/09. The Labour government led by Gordon Brown garnered precious little credit from the electorate for saving the UK banking system from complete meltdown. In 2010 it lost the General Election and was replaced by a Conservative/Liberal Democrat coalition. In Scotland, having surrendered the control of Holyrood it had shared with the Liberal Democrats since 1999 to a SNP minority administration in 2007 that chose to govern alone, it lost the 2011 Holyrood election to a majority SNP government. Then in the 2015 General Election the Conservatives narrowly won outright control at Westminster, while in Scotland the SNP swept the board and left Labour and the Liberal Democrats in the same parlous state as the Tories north of the border with just one MP each. Somehow Labour had meekly allowed itself to be painted as the party of sustained fiscal irresponsibility, consistently borrowing too much and spending too much. Leaving Conservatives to "fix the roof when the sun is shining" or, in its latest iteration, "fixing the foundations" by sorting out the UK's deficit once and for all. The actual numbers show a much more nuanced reality.

The numbers on public sector net borrowing as a percentage of GDP show, as we noted earlier, show the Blair/Brown years starting with three rare years of surpluses and two of minimal borrowing followed by six years of borrowing at similar levels to the Thatcher years. Only after the banks crashed and burned, requiring vast injections of liquidity by the state, did public borrowing spike higher. The Cameron/Clegg coalition promised a period of austerity that would sort the UK's deficit by this year. It only actually managed the rate of reduction Alistair Darling was promising if Labour had been re-elected. The UK government books won't be in surplus, we are now told, until the end of this parliament in 2020. A target that will only be met if George Osborne can find ways of modifying his plans for cutting tax

credits for the working poor and still find the savings elsewhere. In Scotland our fiscal future has developed a whole other layer of complexity. The Calman-inspired Scotland Act will next year transfer a number of tax powers to Holyrood. And, in the wake of last year's independence referendum, the Smith Commission process has added further tax and borrowing powers to that. Successive Fraser contributions have been contributing to this debate. For an early flavor try the debate involving Brian Ashcroft Alex Christie, Kim Swales, Graeme Roy, Paul Hallwood and Ronald MacDonald in 2006 (Vol.31, No.1) and (Vol.31, No.2).

The recession that followed the banking meltdown of 2007/08 is increasingly being dubbed the Great Recession of modern times. Five years on the texture of the recovery we have experienced since continues to feel fragile. Indeed the outlook and appraisal in the latest Fraser Economic Commentary, just published, points to some worrying features of that recovery as it has evolved in Scotland, compared with the UK as a whole. While the pace of recovery appears to be slowing for both, it is weaker in Scotland than in the UK as a whole. In terms of GVA, the UK was 5.8% above its pre-recession peak by mid-2015, Scotland just 3% above. In terms of GDP per head - arguably a better measure of personal prosperity - Scots are still 0.3% below the pre-recession peak, while the equivalent UK average is 0.6% ahead. That, argues the economist Simon Wren-Lewis is "an absolutely terrible performance for a recovery".

In financial services, a major driver of inward investment in Scotland since the decline of Silicon Glen, the picture is even less encouraging. As the latest Fraser outlook and appraisal shows, its GVA contribution had fallen 15.5% by 2012 from its 2007 peak. "There must now be a strong presupposition that the scale of the financial services sector might never return to the levels seen before the Great Recession" concludes Brian Ashcroft. After all what recovery we have seen has been achieved with an extended period of exceptional monetary easing. UK Bank rate has been held at a rock-bottom 0.5% since March 2009. Six years, seven months and counting. Quantitative easing has totaled £375bn. Commodity prices are tumbling. The price of oil has more than halved since Scotland held its independence referendum, with significant impacts on the future of the North Sea. There is scant evidence of the promised restructuring of our economy away from consumption and excessive debt towards more exports, more manufacturing and increased saving and investment. With the latest closures in what's left of the UK steel industry and the continuing haemorrhage of jobs from the oil industry, chancellor George Osborne's 'march of the makers' seems to have stalled. Truly the shadow cast by the most dramatic event of the past fifteen years - that banking Armageddon - is a very long one. One that will continue to impact the Scottish economy for years to come.

Author Details

Alf Young
Visiting Professor
International Public Policy Institute
University of Strathclyde
Alf.young@strath.ac.uk