3. The Scottish Economy

A substantial section of our July Commentary was devoted to an examination of general and regional trends in the Scottish economy over the period 1964-1974. It was remarked that, while the relative performance of the economy had improved over this period, and there were signs of greater business confidence in Scotland, future economic prospects were delicately poised, and might well be vitiated by the recession in world trade and UK domestic demand.

Since July, no additional statistics on Scottish gross domestic product or component aggregates have been published, and the latest available data are for calendar year 1973. In July, we estimated that real GDP in Scotland grew by just under 1% in 1974, compared with a fractional fall for the UK as a whole, and that this relatively better performance had been sustained, though to a lesser extent, during the first half of 1975.

In the absence of additional information, we can add little by way of amendment or qualification to the estimate for 1974, though on the somewhat slender evidence subsequently available we would be inclined to revise the growth rate upwards by a marginal amount. With respect to 1975, it is now clear that a significant revision to our forecast of 1% growth is required. In May, the National Institute Economic Review forecast a rise of 1.6% in UK GDP between 1974 and 1975; in August, this was revised to -0.7%. Our estimate of a 1% rise in Scottish GDP supposed a growth rate of 1 - 1¼% in UK GDP, and must clearly be revised downwards in the light of these events.

Summary of current trends

In the last three months, trends in output and business expectations have reflected to an increasing degree the deepening recession in the UK. More ominously, there are signs that economic prospects in Scotland are deteriorating relative to the rest of the UK, in contrast to the more buoyant (or less depressed) performance of Scottish industry through 1974 and early 1975. If correct, two consequences may follow from this;

firstly, the improvement in the Scotland/UK unemployment ratio may cease, and may even be reversed; secondly, economic recovery in Scotland may lag behind the rest of the UK.

Evidence from the CBI Industrial Trends Survey, and other indicators, confirm that the decline or stagnation in output, the cut-back in investment plans, and falling order books, are widespread throughout Scottish industry. Amongst sectors worst affected, and for which the general economic climate offers little prospect of relief in the short term, are vehicles, paper, metal manufactures, shipbuilding, textiles (including clothing and footwear), food processing and transport. Low levels of consumption expenditure, investment and export demand, substantial cost inflation, and, in some sectors, severe competition from imports, have severally or jointly contributed to these sectors' difficulties.

The recent performance and outlook for many other sectors, though marked by greater uncertainty and variation in the circumstances of individual firms and/or sub-sectors, is also gloomy. Agriculture is squeezed between relatively static farm prices and rising input prices, while the fishing industry is beset by problems which have resulted in a quarter of the deep sea trawler fleet being laid up. The chemicals industry has been strongly affected by the international recession, and there has been a sharp fall in capacity utilisation. And while beer sales reached record levels this year, whisky sales are still depressed, creating problems for the financing of stocks and curtailing plans for capital expenditure.

While North Sea oil has provided a continuing stimulus to certain sections of the mechanical engineering sector, order books are shortening and export prospects are discouraging. Output and employment are expected to fall during the next six to nine months.

Although there are few encouraging signs in the present situation, several sectors appear to be maintaining output and employment, and offer some prospect of expansion. Oil development activity, though sluggish in recent months, should continue to expand throughout the next year, providing additional employment in rig production and service and repair work. Coal mining has been subject to some fluctuations in the last few months, but the recent 10% increase in OPEC oil prices will help the competitive position of the industry and ensure continued expansion. Following poor figures for August, productivity in the Scottish pits increased dramatically in September, and a share of the estimated 6000 additional jobs forecast for the industry throughout the UK should accrue to Scotland during the next year.

An exception to the generally depressed state of manufacturing industry is in electrical and instrument engineering. Except for electronics - which admittedly accounts for a large share of employment - this sector appears to be faring best in current conditions. Employment increased through the first half of the year, and there is currently a shortage of skilled labour, particularly in heavy electrical engineering, where order books are healthy and should ensure a high level of capacity utilisation throughout the remainder of this year and early 1976.

In addition to oil, those sectors which are particularly important as indicators of regionally-generated activity include construction and building materials. Our last Commentary suggested the possibility of some revival in construction activity in Scotland, though the basis for this qualified optimism in the industry was far from clear. In fact, though there has been an improvement in private housebuilding, other construction work has been depressed and there is little sign of the kind of upswing which would suggest a sustained expansion. On the other hand, recent trends in sales of building materials provide some hope that the decline in construction activity may have halted, and there seems to be some optimism in the industry regarding prospects for the second and subsequent quarters of 1976. However, we are less sanguine about the timing of the industry's revival, given the short-term outlook for public authorities' expenditure, planned capital expenditure, and the demand for new private housing. Nor is the current level of interest rates conducive to an early recovery.

More generally, trends in output and expectations in Scotland since our last Commentary show a number of important features. Principally, the majority of indicators which we have used in compiling this summary have indicated a significant deterioration in performance and prospects, not only absolutely but in relation to the rest of the UK. These include

(i) a sharp deterioration recorded in Scotland of new domestic orders, compared with a marginal improvement for the UK as a whole

(ii) more pessimistic expectations in Scotland of new export orders

(iii) a greater expected decline in the rate of capital expenditure in Scottish industry during the next twelve months, compared with the rest of the UK

(iv) a substantial fall in the number of applications for assistance under the Government's regional aid scheme for industry, from 86 in the period May-July 1974, and 51 in the period March-May 1975, to 40 in May-July 1975.

These and similar trends suggest that the relatively better performance of the Scottish economy during 1974 and early 1975, sustained by oil development (and possibly also by the high levels of public authorities' expenditure), is not being maintained. While outlays on oil development continue to sustain a higher level of output and employment in Scotland than would otherwise be the case, the dynamic effects of oil-related expenditure on the Scottish economy have been largely absorbed, at least for the present phase of development. Certainly, oil has cushioned the impact of the current recession on Scotland, and has strengthened the economy, but this has in part postponed rather than avoided the adjustments which have been taking place in the UK economy during the past year. The dominant determinants of (Scottish) regional output are (UK) national demand, and export demand, compared to which the resource requirements generated by an expansion of oil-related expenditure are relatively small (and highly localised). In summary, while the development of North Sea oil has had, and continues to have, a significant impact on the <u>level</u>

of output and employment in Scotland, its direct contribution to the growth of the Scottish economy is presently marginal.

With three notable exceptions, the impact of the current recession on the different regions of Scotland shows a remarkable consistency, in terms of the change in regional unemployment rates between June and September 1975. Although there are marked differences in the levels of unemployment rates in different regions, in nine of the twelve regions the change in unemployment during the June-September quarter has been very close to the Scottish average. This consistency is perhaps surprising in view of the diversity in patterns of economic activity between regions. Indirectly, the figures may be taken as confirmation of the widespread character of the current recession in Scotland.

Regional Unemployment* in Scotland

Region	Sept.1975 %	Sept.1974 %	June 1975 %	% increase in numbers unemployed June-September 1975
Highlands	5.6	3.6	3.7	51
Shetlands	3.0	3.2	2.9	3
Orkneys	2.5	2.4	2.4	4
Western Isles	17.9	14.7	14.0	28
Grampian	2.9	2.0	2.3	26
Tayside	5.3	3.1	4.1	29
Fife	5.7	3.6	4.5	27
Strathclyde	7.1	5.0	5.6	27
Lothians	5.1	3.6	4.0	28
Central	5.7	3.7	4.3	33
Dumfries & Galloway	6.9	4.5	5.3	30
Borders	3.3	1.5	2.6	30
Scotland	6.0	4.1	4.7	28
Great Britain	5.2	2.8	3.6	44

* Seasonally unadjusted and including school-leavers and adult students

Source: Department of Employment

Of the exceptions, Orkneys and Shetland have maintained consistently high levels of economic activity in recent years, and these small areas have been insulated against recession by the impact of oil-related activity on the local economies. In the Highlands region, the major component of the 51% increase in unemployment occurred in July, and may be largely attributable to lay-offs in oil-rig production. In all regions, unemployment has reflected the addition of school leavers to the register.

Unemployment in Scotland - The Present Situation and the Outlook

In our last Commentary we forecast a level of unemployment (seasonally unadjusted including school-leavers and students) of 127,000 in Scotland by the end of 1975 or the beginning of 1976. Figure 1 shows quite clearly that unemployment has already exceeded that figure, although not by very much.

In comparing the unemployment experience of the present recession with that of the last recession, which reached its trough in the winter of 1971/72, several significant differences emerge. There are three major differences on which we wish to focus attention. These are:-

(a) Scotland's position vis-a-vis that of Great Britain
(b) The sex-composition of the unemployed
(c) The problem of unemployed school leavers

(a) Scotland's unemployment experience compared with that of Great Britain

In January 1972 there were 928.6 thousand people out of work in Great Britain. In Scotland at the same time 150.2 thousand were unemployed - 16.2% of the Great Britain total. The unemployment rate in Scotland was 7.1%, 73% higher than the Great Britain figure of 4.1%.

It is already apparent that for Great Britain as a whole the current recession will be much more severe than that of 1971/72. In July of this year unemployment in Great Britain passed the million mark and now

(September) stands at 1194.1 thousand, 28.6% above the January 1972 peak. However, it is not clear that unemployment is Scotland will surpass its 1972 peak figure. At present it is 129.6 thousand - 13.7% below the January 1972 figure. Thus, although Great Britain as a whole is suffering higher unemployment than it did in 1972 the relative shares of the different regions in the Great Britain total have changed, and Scotland has been one of those regions whose share has declined. The marked reduction in Scotland's share of total unemployment in Great Britain is brought out clearly in Figure 2, which plots the percentage share from January 1963 to September 1975. It is worth noting that if this decline had not occurred unemployment in Scotland would be 205.8 thousand at present - 76.2 thousand more than the current figure.

Further data support the argument that Scotland is suffering less badly during the current recession than one might expect from past experience. The number of vacancies notified to careers and employment offices in September was (seasonally adjusted) 16.5 thousand. This constitutes 12.2% of the total number of vacancies in Great Britain, and is a larger figure than one might expect from either the employment or unemployment relative shares. Short time working at a level of 14,000 in September accounted for 10.7% of the Great Britain total. The fact that 10.8% of total unemployment in Great Britain is in Scotland indicates that Scotland's relative position is unlikely to decline sharply, at least in the near future.

However, such relative improvement provides no grounds for complacency. The Scottish rate of unemployment, at 6.0%, is still above the overall Great Britain figure of 5.2%. The fact is that Scotland is suffering badly from the current recession, but less badly than one might expect from previous experience of unemployment during similar phases of the business cycle.

(b) The sex composition of the unemployed

The improvement in Scotland's position, compared with 1971/72, is evident with regard to total unemployment, but it is only partially true when one looks at the composition of the unemployed by sex. For although male unemployment in September, at 96,777, was 22,756 short of its 1971/72 peak, female unemployment at 32,784 had already exceeded its 1971/72 peak, by 2126. Thus women are faring relatively worse than men in the current depression. Figure 3 shows clearly that the total number of unemployed in Scotland during 1975 has included an increasing proportion of women.

There are three possible reasons why female unemployment might be higher during the current recession.

(i) Industries employing a high proportion of female labour may be experiencing larger falls in demand than they did in 1971/72. Although this is by no means generally true, certain industries such as textiles, which is an important source of female employment, have been hit severely.

(ii) More women may remain on the unemployment register rather than withdraw from the labour force entirely. This argument is plausible given increasing family dependence on two steady incomes, but there is no hard evidence to support this hypothesis.

(iii) The equal pay legislation may have reduced demand for female labour by increasing its relative price.

However, although there may be a certain amount of truth in these arguments, we feel that they are insufficient to explain the differing experience of the two sexes. A comparison of female unemployment in Scotland and the rest of Great Britain reveals a broadly similar pattern, while male unemployment in Scotland has been growing at a slower rate than in Great Britain as a whole. Thus, while female unemployment in Scotland reflects the rising trend of unemployment throughout the country, male unemployment has risen more slowly, and it is this which is responsible for the relative improvement in Scotland's unemployment experience. It is clear that male employment in Scotland has to some extent been insulated from the current recession. One obvious reason for this is the (predominantly male) employment created by North Sea oil. However, given the degree of improvement noted, it is at least plausible to suggest that the better performance of the Scottish economy during the past two or three years is more widely based. How firmly based this is, and therefore the extent to which Scotland can maintain its relative improvement with respect to employment, will receive its most important test in the coming year.

(c) Unemployed school-leavers

In the last three months there has been considerable concern with the plight of unemployed school leavers. Current figures for unemployed school leavers indicate the basis of this concern. The highest figure for unemployed school leavers in Scotland before 1975 was 8.6 thousand, recorded in August 1972, when the economy was beginning to move out of recession. In July this year there were 16 thousand school leavers without jobs in Scotland - nearly double the 1972 peak figure. The Great Britain figure of 158.2 thousand in August this year (of which 14.8 thousand were in Scotland) was more than 2½ times the previous peak in August 1972. Thus both in Scotland and in Great Britain as a whole, school leavers are suffering expecially badly during the current decline in economic activity.

To alleviate this problem the government have introduced recently (13 October) a recruitment subsidy scheme. This will amount to a subsidy of £5 per week to firms employing a young person under the age of 20, who has not had more than six weeks' work since leaving school. The subsidy will be paid for each person employed and will last up to a maximum of 26 weeks. It is difficult to predict the success of this scheme. It will to some extent offset costs to employers, such as national insurance contributions, but this may not be sufficient incentive to take on extra labour in industries where order books are already low. One action which might ameliorate the situation in the long run is the more gradual release of school leavers into the labour market. This would reduce the bottlenecks which occur in the market, especially in July and August. Rather than subsidise unskilled employment of school leavers, there is also a strong case for a large-scale expansion of manpower training services for young people. Previous periods of expansion (as in 1973) have been characterised by severe shortages of skilled labour, while at the same time there has been a surplus of unskilled labour. Measures to expand the supply of skilled labour would not only benefit those school leavers (and others) presently unemployed, but would help eliminate bottlenecks in skilled labour markets in future periods of expansion. It is precisely during periods of recession and unemployment that occupational re-training and mobility can be most readily encouraged.

Outlook for 1975-76

During the last quarter, it is clear that the level of economic activity in Scotland, which had hitherto been maintained at a comparatively higher level, moved more into line with the deepening recession in the UK. The improved performance of the Scottish economy during 1974 and early 1975, attributed mainly to the impact of North Sea oil, can be thought to have had two main consequences. First, by the addition of a major growth sector to the Scottish economy, it has narrowed the employment and income differentials between Scotland and the rest of the UK: in the present situation, a major consequence of this is a relative improvement in Scotland's unemployment experience during the present cycle. Secondly, the expansion of North Sea oil activity, coinciding with the current international recession, has postponed (as well as damped) the impact of that recession on the Scottish economy. However, the counter-cyclical effects of oil-related expenditure are now less marked, and trends in Scottish output and employment may now be expected to follow the UK pattern.

This closer correspondence between Scottish and UK trends is reflected in our revised forecast for Scottish GDP in 1975. Such a revision is in any case necessary because of the substantial revision to estimates of UK GDP in 1975; the National Institute, for instance, have revised their forecast of 1975 UK GDP from + 1.6% (May 1975) to - 0.7% (August 1975). Our own average forecast, to which we would attach the same cautious qualifications expressed in the July Commentary, is for a zero rate of growth in Scottish GDP during 1975. However, to the extent that our forecast for GDP in 1974 may have been an under-estimate, Scottish GDP in 1975 would show a slight decline.

In the remaining three months of 1975 seasonally unadjusted unemployment is unlikely to change significantly from its present level of 129,561 because the underlying upward trend will be counteracted by numbers of adult students and school leavers leaving the register. The next sharp rise which may take unemployment to 140,000 is likely to occur between December and January.

In 1976, there can be no doubt that real disposable incomes will continue to fall, at least for the first six months of the year, and that unemployment will continue to rise, reaching a peak during the second half of next year. Only the precise magnitudes offer any scope for differences of opinion.

Partly because of greater-than-usual uncertainty about the numerical estimates of UK GDP during the first half of 1976, but mainly because our figures for Scottish GDP in 1974 and 1975 are themselves forecasts, of unknown accuracy, we do not propose to attach a numerical value to the trend in Scotland's GDP during the first half of next year. To do so would place too much reliance on figures which are themselves subject to substantial margins of error. However, we expect GDP to bottom out during the first quarter of next year, recovering slightly in the second quarter, though not by enough to prevent a further rise in unemployment. Repeating the six-months-forward forecast used in the July Commentary, we expect unemployment in Scotland to reach approximately 145,000 by March 1976 (seasonally unadjusted).

From about the second quarter, we expect a gradual and continuing recovery in output and a modest growth in GDP. On unchanged government policies, and assuming a revival in world trade from about the middle of next year, we would expect an increase of 1% or a little more in UK GDP next year, though increases in exports, stockbuilding, public authorities' expenditure and, in the latter half of the year, some recovery in fixed capital formation. Such growth, however, will not absorb additions to the labour force, let alone reduce current levels of unemployment, and there will be renewed pressure on the government to introduce some reflationary measures. Unless any reflationary measures are accompanied by a convincing "Stage Two" (voluntary) incomes policy, however, there will be severe pressure on sterling, which in turn may preclude a more firmly-based expansion later in the year.

As already indicated, we expect the trend in output in Scotland to follow closely the UK pattern. While growth in oil-related activity may aid recovery in Scotland, other factors, particularly the depression in capital goods industries and the poor outlook for intermediate metal manufactures, offer little prospect of an earlier recovery in Scotland than in the rest of the UK.