University of Strathclyde

The Fraser of Allander Institute

Quarterly Economic Commentary

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. The results of this work are published in the Institute's 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.

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QUARTERLY ECONOMIC COMMENTARY

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Outlook and Appraisal

The Scottish economy appears to have grown less rapidly than Britain as a whole during 1983. This experience is likely to be repeated in the current year but the gap between Scottish and British growth rates should narrow markedly. The pace of growth will not be sufficiently rapid to induce substantial reductions in the numbers of registered unemployed. However the trend of unemployment during 1984 should be very **slowly** downward.

The Treasury's November statement estimated that the British economy expanded by 3% during 1983 and forecast a similar pace of expansion in the current year. Updated Treasury forecasts to be presented in conjunction with the Budget in mid-March are unlikely to differ significantly from those of November. The relative contribution of the various components of aggregate demand is likely to differ between 1983 and 1984, with exports in particular forecast to rise more rapidly during the current year. Consumers' expenditure by contrast is forecast to grow more slowly than in 1983.

Feeding the details of the November Statement into the Fraser Institute's Medium Term Model (MTM) suggests that, if the Treasury forecast proves accurate, the Scottish economy is likely to expand by about 2.5% in 1984, after growth of slightly less than 2% last year. These figures compare with overall growth of 3% per annum in the British economy over the two years in question. The larger difference between Scottish and British growth rates in 1983 reflects the consumption-led nature of last year's British recovery. Scottish consumers' expenditure has a higher leakage outside the regional economy through imports from the rest of the world and the rest of the UK than British consumers' expenditure as a whole. With exports forecast to make a much larger contribution to the growth of aggregate demand in the current year than during 1983, the leakage from expenditure to imports in Scotland will be somewhat less than last year.

British and Scottish manufactured exports consist predominantly of intermediate and capital goods. Consumers' expenditure by contrast is heavily biased towards industries producing consumer goods. Scottish industry is more specialised in the production of capital and intermediate goods than British industry in general. Export led growth in the British economy during 1984 is therefore likely to have a greater trickle down effect on the Scottish economy than the consumption-led upturn of 1982-3.

The forecast implies overall growth of 3% in Scottish industrial production during 1984, compared to under 2% in 1983. The MTM suggests that growth in Scotland's industrial sector will be most rapid in construction and building materials, non-ferrous metals, electrical and electronic engineering, drinks, and timber and furniture. Growth in manufacturing output should be of the order of 2.5% this year, approximately 1% faster than last year. The service sector is also likely to expand more rapidly than last year with particular emphasis on distribution and communications though financial services are forecast to expand more rapidly than the tertiary sector as a whole.

The trend of responses to the CBI Industrial Trends Survey in Scotland over the year to January 1984 is consistent with the sectoral forecasts derived from the MTM. The most recent CBI Survey recorded a more optimistic outlook amongst its Scottish sample than has been evident for some years. Nonetheless, the Scottish Survey continues to yield responses on all the important questions which are less encouraging than those of British industry as a whole, a pattern which first emerged in 1980/81 and has persisted almost without interruption since then. Other indicators are consistent with a relatively sluggish Scottish industrial performance in the upturn to date, the most recent being the plateauing of short-time working in Scotland at the end of 1983 compared to its continued fall in British industry as a whole. Thus while confidence is on the increase in Scottish industry, the increase is less marked than in the wider British economy. However, with increased emphasis on export led growth, the gap between Scottish and British performance should narrow during 1984.

The boost to Scotland's growth rate which exports are expected to generate during the current year is but one aspect of the increasing dependence of Scottish economic prospects on external events. Two other aspects are worthy of note, each affecting a particular sector of the economy. Debt burdens have induced many developing countries to limit non-essential imports, amongst which is whisky, while EEC budgetary problems make changes in the CAP appear imminent. A reformed CAP is likely to place much greater emphasis on setting guarantee and intervention prices at levels which will curb oversupply. While desirable from a Community perspective, the net effects of such a move are likely to prove harmful to Scottish agriculture.

Growth prospects in Scotland during the current year are heavily dependent on exports. The competitiveness of British and Scottish industry now appears to be back to the levels of 1979 on both home and export markets. However, given the extent to which the industrial base has contracted during the recession, further gains in competitiveness may be required if increasing employment is to be generated in the industrial sector. That means reducing industrys' unit costs of production. The Chancellor could make some progress towards this end in the Budget by abolishing the National Insurance Surcharge. This is a particularly desirable measure, in terms of generating employment perhaps more desirable than any real reduction in the burden of personal taxation.

Domestic demand in Britain does not require a boost at present. What does require a boost is the share of that demand captured by British and Scottish firms. Reduction or abolition of the National Insurance Surcharge would be an appropriate measure to that end. Such a boost to the competitiveness of domestic firms would be particularly timely as the recently announced Rate Support Grant Settlement for Scotland embodies a further reduction in the share of local authority expenditure funded by central government and a consequently 3% greater increase in industrial rate bills than would otherwise be warranted.

Budgetary measures to improve competitiveness may be of particular importance to Scottish firms if, as expected, the government's restructured regional policy includes substantial reductions in the absolute amount and share of regional aid allocated to Scotland. Given the extensive coverage of regional aid in Scotland such reductions may have a proportionately greater effect on Scottish firms than on British firms in general. Offsetting measures are therefore required to maintain the competitiveness of Scottish firms on export markets, if not also at home.

Increased output is the solution to unemployment. The forecast pace of growth in the Scottish economy is not sufficient to make substantial reductions in unemployment. In many parts of Scotland those currently on the register have less than a one in eight chance of leaving the register during the coming month. Such a situation demands action more radical than the government seem poised to take.

22 February 1984