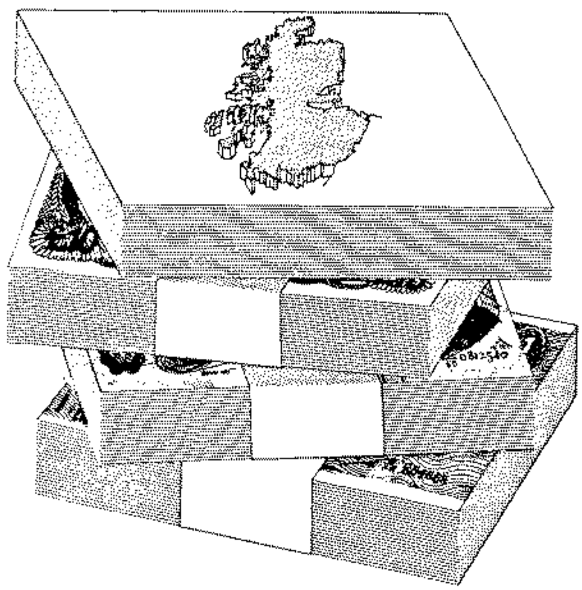
The Scottish Economy

Industrial Performance



BUSINESS SURVEYS

Between them the Scottish Chambers' Business Survey (SCBS) and the CBI's Industrial Trends Survey provide a reasonable guide to current and recent trends in the Scottish economy. Both surveys are carried out on a quarterly basis with results being derived from the responses of Chambers of Commerce and CBI members, respectively. While the two sources are complementary in nature there do exist important differences between them. Whilst the SCBS provides a geographical breakdown of responses, the CBI Survey provides information on trends by size of firm. Also, the CBI survey provides information on sectoral employment patterns, whilst the SCBS distinguishes between male and female employment and between full and part-time employment. Furthermore, the number of respondents to the SCBS is well over twice that to the CBI survey and they cover not only Manufacturing but also Construction, Wholesale Distribution, Retail Distribution and Financial Institutions. The results from the SCBS are therefore open to a greater degree of disaggregation than those of the CBI survey.

The October, Scottish Chambers Business Survey was conducted during the period between 2 September and 19 October 1988. Over this period growing inflationary pressures prompted a series of interest rate increases and a balance of payments deficit. The trade weighted value of sterling remained more or less unchanged over the period.

SCBS

Respondents to the SCBS remain optimistic in their outlook. The optimism is broadly based with all sectors expecting to enjoy the benefits of continued economic expansion. In the short-run, growth is likely to be most pronounced in construction and wholesaling activity. Manufacturers of capital goods are also likely to experience growth in orders and output with the recent strong growth in investment expenditures.

The effects of recent increases in interest rates on Scottish economic activity are difficult to disentangle. The October SCBS gives little indication of what they are likely to be. To the extent that the increase in interest rates deters potential investors, there will be adverse consequences for Scottish manufacturing activity, and indeed for longer term growth of the economy. Evidence indicates, however, that interest rates are unlikely to exert a strong influence on investment. If expectations of future profits remain firm, investment demand is likely to be largely unaffected. An indirect threat to investment may however materialise through wage pressure, induced by the accelerating rate of inflation. If earnings growth is not matched by advances in productivity then, over the short-run at least, this may erode profits and lead to a contraction in planned investment projects.

Fears that the buoyant demand conditions presently enjoyed by Scottish manufacturing may be short-lived are, therefore, premature. The most vigorous Scottish manufacturing activities are those which are producing capital goods for the rest of the United Kingdom and rest of the world markets. If investment demand in the UK economy continues to expand into 1989 then we can expect Scottish manufacturing activity to expand further. Although a question mark remains over the possible adverse consequences of interest rates increases and spiralling earnings (unmatched by productivity growth) Scottish manufacturers remain optimistic about their general business situation. In the October Survey a positive balance of 5% of manufacturing respondents are more optimistic than they were three months ago. This is underlined by expected trends in: new orders; sales volumes and employment. All are expected to grow still further in the last quarter of 1988, consolidating the strong performance of manufacturing in the earlier part of the year.

However, the performance of Scottish manufacturing swings dramatically from east to west. Respondents in Aberdeen, Dundee and Edinburgh are uniformly pessimistic about their general business situation. Only respondents from the Glasgow chamber, who carry a large weight in the total returns, claim to be more confident about their future prospects. Reported investment intentions more or less confirm this regional divergence in economic fortunes. It would appear, however, that Dundee's economy is not performing so badly as a casual inspection of respondents "general business confidence" would seem to indicate. Actual and expected orders and sales in Dundee continue to show signs of strong growth as does employment, and investment. Aberdeen's poor performance is, of course, largely attributable to the faltering performance of oil and oil related activities but the disappointing performance of manufacturing activity in Edinburgh is something of an enigma. It is conceivable that for this region our sample of firms is unrepresentative.

For a considerable period retailing activity has been experiencing sustained growth. In the last quarter's SCBS there was, however, a hint that the growth of retailing activity might be about to slow. This slow down is again reflected in the returns for the last quarter. The balance of respondents who report increased business confidence in this survey (October '88) is, at 16% much smaller than the peak levels recorded at the start of the year. Nevertheless, conditions in the retailing sector are far from being depressed. Sales volumes increased in the last quarter for a larger balance of firms than had previously been anticipated. This growth in sales volumes is expected to endure. A balance of +20% respondents in retailing expect an increased trend in their sales over the next quarter. Although respondents are asked to exclude seasonal influences from their replies, prospects for employment, which suggest a large increase in part-time employment, are most probably attributable to the peak in retailing activity which occurs over Christmas.

If recent increases in interest rates are effective in constraining consumer expenditure then the outlook for Scottish retailing may be less promising than of late. It is far from clear, however, whether the increases in interest rates will be effective in reducing Scottish consumer expenditure, especially over the short-run. To the extent that consumer expenditure is related to personal sector equity in housing, it is unlikely that interest rate increases will constrain consumer expenditure in Scotland. There is every indication that house prices may continue to increase in Scotland for some time (although this may not be true of other areas of the United Kingdom, particularly the South East). Increases in personal sector wealth may then continue to finance consumption expenditure in Scotland for some time yet. Additionally, to the extent that consumption behaviour is habit forming and personal sector transactors are able to roll forward their credit commitments, interest rate increases may take some time to bite on consumption. Consequently, there is no reason to suppose that the retail sector is about to experience a dramatic reversal of fortunes as consumer expenditure contracts in the face of increased finance charges and reduced personal sector wealth.

The prognosis for wholesaling activity is much as it is for retailing. Respondents from wholesaling to the SCBS are unequivocally optimistic about their general business situation. A net balance of +66% of wholesaler respondents experienced increased sales during the third quarter of the year. This confirms the optimism expressed by wholesalers in July. Moreover the buoyancy in wholesale activity appears to be economy-wide. Respondents to all chambers are unanimous in their expectation of a further increase in their volume of sales. There is also a general expectation that employment will increase in the wholesaling sector.

Construction respondents are easily the most optimistic in the SCBS. A positive balance of +59% of respondents are more optimistic about their general business situation than they were three months previously. This optimism is ubiquitous, and covers orders from all sectors.

Capacity utilisation is uniformly high in all areas and it is even possible that a bottleneck in construction activity may occur in the coming months. The expansion of construction activity reflects a number of recent developments. First, the Scottish housing market has recently experienced healthy growth. Secondly, the expansion of investment in buildings and floorspace has had favourable repercussions on construction. Finally it is possible that the decision to levy VAT on certain new construction projects has meant that some of these have been brought forward in time. Whilst, notwithstanding interest rate increases, we would expect housing and manufacturing investment demand to remain healthy (at least over the short-run), this last stimulus to demand is, of course, only temporary.

In the last quarter, Scottish financial institutions report that they increased their advances to both the corporate and personal sectors. Over the next quarter however, financial institutions expect that on balance, the demand for advances from the personal sector will contract. Advances to the corporate sector are also expected to rise less quickly than in the recent past. Presumably, these expectations reflect the series of increases in interest rates which have occurred in past months. To the extent that the expectations of Scottish financial institutions are validated, there is, of course, likely to be knock-on effects on both consumer and investment demands. It will be several months yet before the trend of actual advances becomes clear.

CBI SURVEY

The main results of the CBI Survey, which are confined to Scottish manufacturing, broadly reflect those of the SCBS. The CBI reports: an increase in business optimism in the third quarter of 1988; an increase in investment intentions and a rising trend in Scottish manufacturing employment. However, the CBI Survey results are less optimistic than those of the SCBS and suggest a slowing in the growth of business confidence.

The growth in demand for the output of Scottish capital goods sectors in the SCBS is not so pronounced in the CBI returns. Whilst respondents in Mechanical, Instrument, Electrical and Vehicle engineering are clearly more optimistic than they were four months ago, the position of the Metals and Metal Manufacture sector is more equivocal. With the exception of Food, Drink and Tobacco, the CBI Survey suggests that consumer goods industries are performing less well than capital goods industries.

The CBI survey reports that unit costs in manufacturing have continued to increase over the third quarter of 1988. Moreover respondents expect that average unit costs will rise at a faster rate in the coming months. This expectation is universal. To the extent that increased wage demands are associated with accelerating inflation, costs may rise even further than is anticipated. To the extent that increased costs are passed on in prices, the competitiveness of the Scottish (and UK) economies will be weakened, so posing a threat to the continued growth of the economy.

SUMMARY

Both the CBI and SCBS surveys report trends which indicate that, at least over the short-run, growth will be maintained at a healthy rate. Manufacturing activity, which for a long-time lagged behind growth in services, appears now to be sharing in growth. Whilst a question mark hangs over the effects of recent interest rate rises on domestic demand, there appears little indication yet that their effect is being felt by respondents to either the SCBS or CBI survey. The most recent interest rate rise in late November may, however, bring forward any possible deflation.

Primary

AGRICULTURE AND FORESTRY

Recent issues of this Commentary have referred to the controversy surrounding British forestry policy in general, and its application to Scotland in particular. Three sets of policy changes are beginning to take effect which may well have considerable impacts upon the actual practice of forestry.

The first concerns a recent European Community directive recently brought into force. This directive, operational from August 1988, provides that all plantings over 100 hectares planned by the private sector must be accompanied by a detailed environmental plan; if planting of any size if proposed in certain designated areas, such plans must also be produced. Such plans will be open to public scrutiny and if either the Forestry Commission (FC) and/or the relevant Minister are not satisfied that the proposals are environmentally acceptable, planting grants may be withheld.

This scheme appears however to exclude the FC from the requirement to produce such plans; the FC is responsible for approximately one half of current planting, and by no means has been immune from criticism concerning its planting practices in the past. Furthermore, "quangos" such as the Nature Conservancy Council have no statutory right to be involved in the consultation process, and the requirement to produce such plans does not appear to be necessary if planting grants are not being sought.

The second policy change refers to the new farm woodlands scheme, introduced in September, 1988. This is being introduced for a trial period during which farmers are being offered generous grants to use land formerly in livestock rearing or arable production as woodland. For Great Britain as a whole, the target is 36,000 ha over the next three years, which is expected to cost about £10m per annum.

Again, the impact of this (and the likelihood of these targets being met) is difficult to assess. Farmers have to compare these incentives with the set-aside schemes, where a less long term commitment to land use change would be made.

The third major change concerns the fiscal changes announced in the last budget. Bridget Bloom (Financial Times, September 6, 1988) provides the following data on the changed Woodland Grant scheme which has recently been introduced, consequent upon the removal of the tax incentives to planting prior to March 1988. (Although it is worth remembering that a five year transition period means that these tax incentives will disappear only gradually in practices.)

Post-Budget Woodland Grant Structure - £ per hectare (old rates in parentheses)

Area (hectares)	Conifers	Broadleaves
0.25 - 0.99	1005 (630)	1575 (890)
1.00 - 2.99	880 (505)	1375 (735)
3.00 - 9.99	795 (420)	1175 (630)
10.00 and over	615 (240)	975 (470)

Not only have the absolute levels of grant been increased markedly in absolute terms, but the relative increment in favour of broadleaves has changed in structure. For smaller woodlands the relative increment has increased whilst for larger plantings it has decreased. It is not absolutely clear whether decisions respond to the absolute or relative difference; if the absolute difference is what matters (as we would expect) then the increased absolute differential in favour of broadleaves might encourage greater diversification of woodlands; the extent of such diversification depends of course on the relative rates of return on different forms of woodland, net and post grants.

Looked at another way, the grant on large scale conifer planting has now trebled. This will create a major incentive to attract new investment in this direction, perhaps sufficient to more than offset the reduced planting that some felt would result from the abolition of income tax incentives in the last budget.

One of the major debates in Scottish agriculture is the likely pattern of changing land use in the medium term, particularly in response to schemes such a 'Set Aside'.

By October 7th (two weeks before the final application date) 1,720 applications had bee received, covering a total of 118,000 hectares. Various trials are being carried out in both commercial and public sectors to attempt to identifying optimum patterns of land use for 'set aside' land. Research is suggesting that whilst there are many positive benefits, including new habitats for fauna and flora, possible negatives exist; these include increased carry-over of plant diseases, and invasion of land by species such as bracken which may prove difficult to control at a later date, and which could encourage the spread of ticks and associated disease.

The Common Agricultural Policy (CAP) is becoming subject to increasingly regular attack from within Britain. This has been seen most recently in a report "Consumers and the CAP", prepared by the National Consumer Council and commissioned by the UK Department of Trade and Industry. The report is highly critical of the CAP, arguing that it adds £9 per week to the average family's food bill and that it is responsible for major allocative inefficiencies in primary production. The report urges a modified market response, with direct users for limited period to help farmers during the transition period.

It clearly is the case that price support schemes such as the CAP do create large economic costs, but the nature of primary production suggests that the visible costs of price or income support schemes are likely to be substituted by less visible but no less real costs if market forces are left to allocate resources. Unlike manufacturing and service (and most other extractive) sectors, production is not amenable to close and continuous control, resource and product reallocation is very discontinuous and the demand and supply elasticities are probably very low; large price fluctuations and volatility are endemic, and in the face of very limited resource mobility, adjustment costs are of necessity very dramatic. This is reflected in the fact that it is very hard to find cases where market allocation is left to proceed unhindered in any country or period of time; indeed even the present Government, strongly committed to market allocation processes, seems unwilling to accept such a route in the case of agriculture.

However, one area in which such moves are being contemplated by the government is the area of agricultural research. A major government review has recently suggested that a substantial shift of research work should take place from the agricultural colleges and research establishment to private industry. The Institutions of Professional Civil Servants believes this will leave the major Scottish establishments facing substantial funding costs over the next three years.

FISHING

Official statistics on the volume and value of fish landings in Scotland for the first nine months of 1988 are presented in Table 1, where the percentage change from the same period one year earlier is given for comparison.

The activity level of UK vessels has shown little aggregate change, with a 3% rise in volume. Average prices for all species dropped by 6%, leaving a small fall in the value of total UK landings. It is interesting to note that foreign vessels also landed an amount considerably greater (by 133%) than in the respective period one year earlier; however the value of these landings fell because of significantly lower prices for these

Table 1 Fish landings by UK vessels at Scottish Ports - Selected species: January to September, 1988

	Weight (tonnes)		Value (£'000)		Av. Price per tonne (£)	
Landings of:						
Demersal	200,702	(-3)	130,332	(-8)	649	(-5)
Pelagic	140,829	(+11)	16,390	(+13)	116	(+2)
Shellfish	32,333	(+17)	42,779	(+9)	1,323	(-7)
Selected Species						
Cod	35,583	(-20)	33,366	(-15)	938	(+61)
Haddock	67,228	(-6)	49,344	(-8)	734	(-3)
Whiting	25,987	(-9)	13,472	(-10)	518	(-1)
Saithe	10,900	(-4)	4,093	(-20)	376	(-16)
Sandeels	30,171	(+39)	1,090	(+70)	36	(+22)
Mackerel	51,566	(+28)	6,095	(+42)	118	(+11)
Herring	84,150	(+2)	10,090	(+1)	120	(-1)
Crabs	4,120	(+15)	2,695	(+39)	654	(+21)
Scallops	3,274	(-12)	4,682	(-16)	1,430	(-5)
Norway Lobsters	15,146	(+29)	27,265	(+16)	1,800	(-10)
Queen Scallop	2,351	(-30)	880	(-46)	348	(-23)
Total by UK vessels	373,865	(+3)	189,501	(-3)	507	(-6)
Landings by foreign vessels	24,119	(+133)	3,634	(-18)	151	(-65)
Total landings in Scotland	397,983	(+7)	193,135	(-4)	485	(-10)

Figures in parentheses represent percentage changes from period (January to September) 1987 to (January to September) 1988.

Source: Department of Agriculture and Fisheries for Scotland.

types of landings.

Demersal (whitefish) landings showed falls by both volume and value. The two main species in this group (ie cod and haddock) both exhibited large falls by weight, with cod weight falling by 20%. Average prices, although rising for one or two species, typically fell, resulting in value of landings falling for most of the important species. Indeed landings have risen dramatically (by 39% in weight), making this one of the major species to the UK industry.

Landings of pelagic species, such as herring and Mackerel, rose in value by 13% to £16.4m. Herring landings changed little in terms of either weight or price, as the main herring fishery draws to a close. Mackerel landings strongly increased, both in volume (+28%) and value (+42%) terms.

The shellfish sector shows, as is common, a rather more varied picture. Landings by weight of crabs and norway lobsters showed particularly large increases (15 and 29% respectively) with large volume falls in scallops and queen scallops. Price volatility was very marked for shellfish species.

Previous issues of the COMMENTARY have referred to the ecology of fish farming. A major report, commissioned by the Highland and Islands Development Board (HIDB) and a number of other bodies, and carried out by Dr R Gower of the Scottish Marine Biological Associates and Dr Donald McLusky of Stirling University has just been produced, studying the relationship between agriculture and the environment.

The report suggests that fish farms can affect the ecological balance within a neighbourhood (60 metres) of the sites, but that rotation of cages can reverse these effects. A model has been constructed which allows simulation of the effects of fish farms, and which can be employed to give policy advice on the siting of cages. The model suggest that, given a site of sufficient depth and water exchange, the site is unlikely to be 'soured'. Ecological effects were found to be very limited in scope in terms of space, the main effects being limited to a 15 metre radius; the recovery rate of the ecology may take up to three years in typical cases, but permanently damaging effects were not discovered.

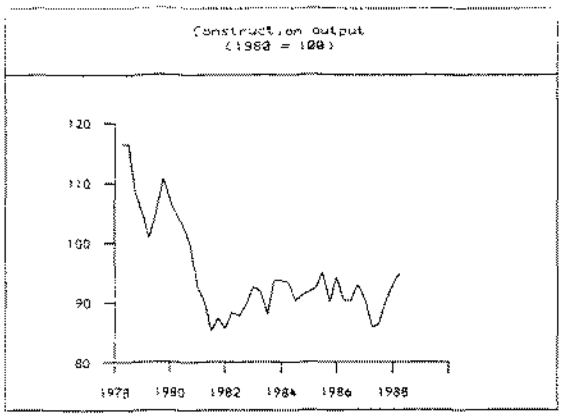
Salmon farming is, as we have reported previously, a growth industry; it is estimated that the industry currently employs 850 full time persons, plus 300 part time, and related employment is in the order of 2,000 jobs. The present output of 12,721 tonnes (1987) is expected to increase by over 400% by 1991, which would make this species one of the top commercially landed species in Scotland.

Little if any contact has existed between Icelandic and Scottish fishfarmers since the 'Cod Wars' of the 1970s. It is interesting to note that agreements were signed in September for British sales of fish to Iceland for the first time; it appears to be the case that Icelandic waters are curtailing harvests below her processing capacity.

Construction

The index of production and construction indicates that the construction industry in Scotland began 1988 in considerably better fettle than it did 1987, a view very much in line with a variety of other indicators. The provisional index of construction for the first quarter of 1988 stood at 95.0 (1980 = 100) 10.7% higher than the first quarter of 1987 and the highest single quarter's figure recorded since 1985. Despite this improved performance the Scottish index continues to lag further and further behind its UK counterpart. In the first quarter the UK index rose to 121.1, 10.2% above the figure for the first quarter of 1987 and fully 28.3% above the Scottish index. Thus Scotland continues to obtain a decreasing proportion of total UK construction, a situation which has persisted for several years.

Nevertheless, in absolute terms the outlook does appear brighter than in recent years, a fact borne out by several other indicators. One of these is the official figures on contracts obtained by contractors in the building industry. It should be remembered that, unlike the index of construction mentioned above, these figures are in current prices as opposed to real terms, and are subject to substantial short-run fluctuations. Nevertheless, the contracts data do give some guide to the current state of the market, and this information does have the advantage of being slightly more up to date than the index of construction. Total new contracts for the first half of 1988 were £887m, 18.6% higher than the first half of 1987. However, both public and private sector housing starts were down on the 1987 figure, by 13.3% and 6.4% respectively. Despite the fall in the value of housing contracts, public sector orders have been very buoyant overall in the first half of the year, rising by 38% over the corresponding 1987 figure to £381.06m. It is difficult to tell what the real source of the increase is since the largest single rise occurred in the "miscellaneous" category; this sector is well named, including as it does industries as diverse as agriculture, oil, entertainments, communications and a catchall sector for all the bits which do not fit anywhere else.



Private sector orders also rose in the first half of the year, but only by 7.1%, less than one-fifth of the percentage rise registered by public sector orders. In line with recent optimism from the retailing sector, new construction orders for shops were particularly high in the second quarter, running at nearly three times the level of the second quarter of 1987 (£58m).

The National House Building Council's latest figures for private housing starts indicate that in the third quarter starts in Scotland continued to rise. The total number of new starts registered by the NHBC in Scotland for the first nine months of the year was 11,000, 41% higher than the figure for 1987. This rate of growth considerably outstrips that of Great Britain as a whole (16% for the same period). Interestingly, GB starts in the third quarter were only 5% up on the third quarter figure for 1987; whether this is a minor blip or the beginning of a slow-down in the housebuilding boom will not become apparent for some time.

The recent increases in mortgage rates will eventualy work their way through to the housebuilding market, as will the influence of changing house prices. Recent data on house prices indicates a "ripple effect", with the rate of increase of house prices now slowing down in the South East (and especially in Greater London), but very rapid rises in prices now being experienced in the Midlands and, to a lesser extent, Wales. Scotland has, until recently, escaped the worst of the house price spiral but there is now some evidence of the "ripple" reaching parts of Scotland, especially desirable "dormitory" areas such as Helensburgh. Of course, it would be unwise to read too much into aggregate data, since Scotland is very far from being a homogeneous housing market.

Clearly construction firms expect the recovery to continue for some time, judging by the optimistic returns from the latest Scottish Chambers' Business Survey.

A net 59% of responding firms is more confident about the general business climate than was the case in July, continuing the optimistic note of recent Surveys. As before the private sector is the strongest source of demand for construction, with a balance of 73% of firms reporting a increase in new orders from this sector in the third quarter, with a net 65% expecting further growth in the final quarter.

It is not just the strength of the housing market which has led to these optimistic results. The imposition of VAT on certain categories of new work has provided an incentive to bring forward planned construction projects, and this has coincided with firms in both manufacturing and distribution meeting physical constraints which in some cases can only be relieved by new building work. Even though the "VAT effect" may be short-lived, the continuing buoyancy of both the housing and public sector markets is very encouraging.

The Survey also indicates optimism on employment; a net 73% of responding firms reported an overall increase in employment with a net 35% anticipating a further increase before the end of the year. There is, however, some indication that the construction sector itself may be starting to experience capacity problems. The level of capacity utilisation remains high at 85%. However, 55% of firms now state that a lack of skilled labour is now acting as the principal constraint on output, a significant change from recent Surveys which showed a steady 20% of firms experiencing this difficulty. It is too early to say whether this is anything other than a temporary phenomenon, but it is certainly unwelcome as the industry experiences its first sustained rise in overal activity for many years.

Earlier, brief mention was made of the impact of higher mortgage rates on housebuilding. A recent analysis by Phillips & Drew, a large securities house, indicates that construction is the most vulnerable sector of the UK economy to higher interest rates generally. This conclusion is based on a long-run multiplier type model of the economy, and leads to the conclusion that, for example, a 2% rise in base rates could be expected to lead to a 1.2% fall in construction output over a three year period. This is a larger overall effect than for any of the other 29 sectors examined. Of course, this is a relatively small effect, especially for the UK as a whole which has been experiencing a sustained boom in construction. However, if the estimates hold true for Scotland then this could be a matter of some importance given the much slower and more limited recovery displayed by the industry in Scotland.

CALA, housebuilders from Aberdeen, bought the last 25% of Merebrook Properties in October. Last year CALA acquired 75% of Merebrook. The recovery of FJC Lilley continues apace, with interim profit figures of £3m announced in mid-November, a remarkable turnround from the position of less than two years ago. The company is now once again able to pay a dividend.

In October the Property Services Agency awarded a contract valued at £66m for the construction of a floating jetty for the Royal Navy at Hunterston. The contract is expected to provide 200 jobs during the construction period.

Energy

OIL AND GAS

The Royal Bank / Radio Scotland oil index in September was 131.7 (1980 = 100). This is equivalent to production of 2.17 million barrels per day, and was the third month in a row in which daily production was just over 2 million barrels. It is now estimated that the Piper Alpha disaster has led to a 12% reduction in UK oil output. The estimated daily value of oil production in September was £17.1 million, £1.7 million per day less than in August, and the second lowest average daily oil value recorded since the index began in 1983. The main cause of this was a $1.63 drop in the average price of Brent crude over the month, not sufficiently offset by a 1.7% depreciation of sterling against the dollar.

Recent months continued to see substantial volatility and uncertainty in world oil markets, reflected in fluctuating oil prices. In October alone, prices for North Sea crude cargoes varied from $11.20pb to $13.55pb. The problems are accelerated by the fact that, in spite of existing significant excess supply, global oil production appears to be increasing. The International Energy Agency estimates that production in September averaged 50.8mbpd, the highest for eight years. OPEC's contribution was estimated to be 20mbpd.

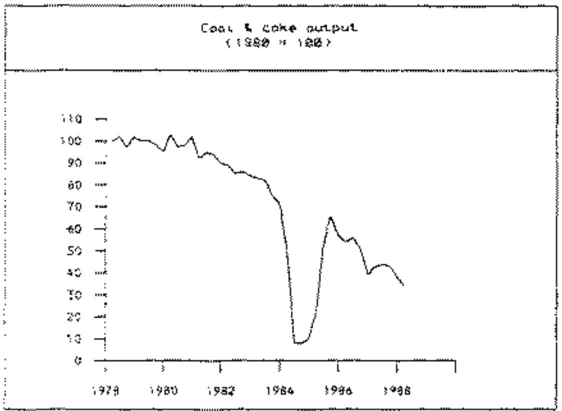
In fact, OPEC is held by most experts to be primarily responsible for the disarray in world markets through its inability to constrain production to agreed quota ceilings. In October, OPEC produced 21.7mbpd compared with a self-imposed quota of 15.06mbpd (excluding Iraq). Over-production was led by Saudi Arabia, Kuwait and the UAE, while Iraq, whose unwillingness to accept a quota less than Iran's 2.36mbpd is one of the major sources of OPEC's internal disagreements, contributed to the problem by producing 2.7mbpd.

In the domestic oil and gas industry, two major new developments, both involving BP, were announced in October. On the 11th, the Department of Energy gave its approval to the £1.2bn Miller field project. BP estimate that a peak onshore workforce of around 3,700 will be required during the production phase, with a further 1200 jobs involved in offshore installation. There will be permanent employment of around 200 on the platform. Total recoverable reserves are estimated at 300mb of oil and 57bn cft of gas. Production, expected to peak at 113,000 bpd, will begin in late 1991. Associated gas from Miller will be sold to the North of Scotland Hydro Board for electricity generation at

Peterhead. This had prompted some fears that the substitution of gas for coal-generated power will have an adverse effect on the Scottish coal industry.

The other October announcement was that BP plans to almost double ethylene production at Grangemouth. Expanding the site to produce another 250,000 tons per year will cost £200 - £230 million. Up to 70 new high technology jobs could he created onsite.

COAL, ELECTRICITY AND OTHER ENERGY

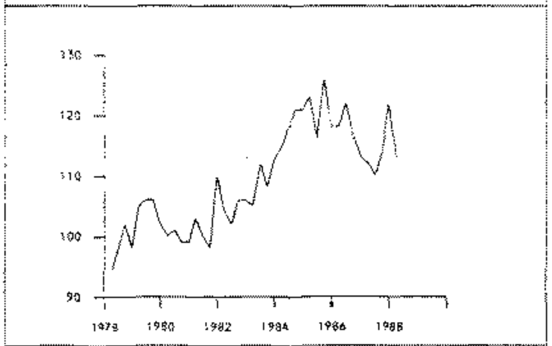


They cheered Cecil Parkinson to the very echo at the Conservative Party Conference in Brighton last month when he announced that a commitment to privatise British Coal at the earliest opportunity would be found in the Party's next manifesto. To the pure of spirit it was confirmation that one of the last remaining state-owned industries will find a home in the private sector. For many, however, it was a sign that final punishment will descend upon the National Union of Mineworkers. There are, of course, no details of the shape of the privatised coal industry which is expected to emerge. In fact, it was widely whispered that the Secretary of State for Energy was simply testing the limits of the Conference clapometer. However, privatisation of British Coal in the 1990's raises a host of issues which merit consideration but which can only he mentioned here.

First, privatisation is at least three years away and probably four or more. By that time the electricity supply industry will be firmly established in the private sector and the key issue of coal supply sourcing will have been settled; and it is this which will determine the overall size of the industry. If the electricity companies, and, principally, the CEGB and its successors, opt for importing coal on the scale of 70m-75m tonnes per annum, there will be little left of the UK coal industry save a few large and low cost pits in the core regions and the burgeoning open cast sector. Certainly deep-mining in Scotland would have been consigned to the history books. If, on the contrary, coal importing is limited to power stations on the Thames Estuary, there will be a large and relatively stable market for a coal industry producing at tonnages not much lower than the present level. However, that output will he produced by fewer pits and markedly fewer miners. Thus, the very scale of the industry is, as yet unknown. However, as has been argued in previous Commentaries it would be foolhardy of the electricity companies to choose the coal importing option to the exclusion of domestic supplies since imports are insecure, require capital investment (in terms of coal-handling equipment), are presently subsidised and the international market for coal is a small one.

A second issue is the one of the possible structure of the industry. Of all the industries, past and future, which have been considered for privatisation, coal is the one which offers most scope for increased competition and is, therefore, the one for which maintenance of the organisational status quo - a national company - would be least acceptable politically. The individual unit of production, the colliery or opencast seam, might be sold. The result here would he the purchase of the most profitable collieries and the end of cross-subsidisation of loss-making faces and pits. The sale may he based on regional groupings of coal operations, which in the case of Scotland would see profit arising from the surplus earned by the open cast operations. A further option would be to float the deep-mining and opencast operations separately, and perhaps regionally. The fourth option would be solicit offers for pits (or groups of pits) from co-operatives of workers and/or managers. Apart from the scale and structure of the industry, a third concern is precisely who would own the new industry and would ownership and control be limited by statue. The importance of this point is that potential bidders would include the oil companies who have seen coal as a means of diversification. However, coal and oil and gas are direct competitors and the nation's long-term energy needs might not be best served by allowing control of so many sources to be in so few hands. A fourth concern, for the employees at least, will be to ensure that adequate safety standards will be maintained in the profit-seeking environment of privatised coal-mining.

Other energy and water supply output (1980 = 100)



Apart from the level of demand the medium term outlook for coal is now determined by two factors, each exerting further downward pressures on costs: the privatisations of electricity and coal. The management of BC can, therefore, be expected to pursue further cost reductions; the corporation is already committed to increasing labour productivity by around 50 per cent over the next five years. Added to these pressures in the Scottish case is the competition from gas over the longer term on two fronts. First is the change in pricing policy introduced by Norway's Statoil. In the past the price of gas was closely linked to oil prices, thus making it unattractive to electricity producers who were locked into long-term purchasing arrangements. However, Statoil has recently secured a deal to supply gas to two Netherlands power stations for twenty years from the mid-1990's. The innovative feature of this contract is that the price of the gas takes account of the cost of imported coal. Such a pricing formula might make gas preferable to coal in Scottish power stations. Secondly, and of greater immediate significance, the government has authorised the burning of gas at Peterhead thus enabling the North of Scotland Hydro Electric Board to conclude an agreement with BP for gas to be piped from the Miller field to Peterhead.

With the new South Electricity company having access to half of Peterhead's output combined with the cheap, base load power generated from Torness, the SSEB's bargaining position when looking for cost reductions from BC is now extremely strong. Put simply, BC's Scottish operations must now provide coal to the SSEB much more cheaply or deep-mining in Scotland has no future, a pressure which has been intensified by the two electricity boards' poor financial performances in the year to March.

Although BC has announced that it will freeze its power station coal prices over the next year, that is not the result of pressure from the SSEB. Rather the CEGB - which buys more than twenty times as much coal from BC - is the customer which must be satisfied. However, a simple freeze on current contract prices will be unacceptable to the SSEB.

Amidst the gathering gloom, Fife Regional Council has granted BC planning permission for a combined opencast and deep-mining operation on the site of the now-redundant Frances Colliery. The project, if it proceeds, will see opencast mining at the site for around six years until 1997, following which a deep mine will be sunk. The economic benefits to the area would be substantial but are dependent, first, on the availability of a market in which to sell the coal and, secondly, on BC authorising the investment. There should be little problem in securing a return from the open cast operation, it being the profitable part of the industry in Scotland with major industrial and (Northern Irish) power station contracts. The problem lies with the deep-mining proposal given the uncertainty of the nature of the market in the late 1990's and beyond.

There was some discussion of the woes of the Bilston Glen pit in the previous Commentary. Output had slumped to around 11,000 tonnes per week in the early summer, well below the break even point of 18,000 - 19,000 tonnes. In spite of some improvements after the initial problems there has been a recent deterioration in output levels and the pit is under threat once again. This and the problems of a similar nature now facing Ayrshire's only remaining colliery, Barony, will be discussed in more detail in the next Commentary.

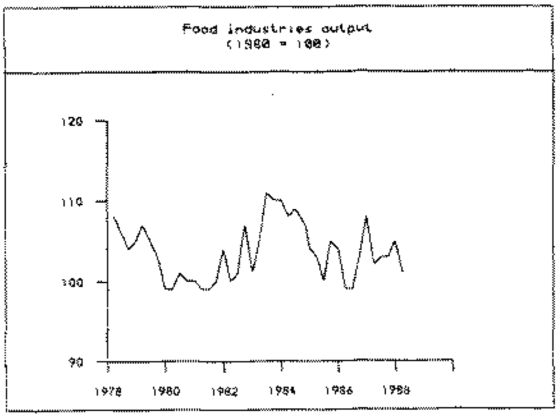
Most of the foregoing has been a litany of depressing developments for the Scottish coal industry. Indeed, the outlook is bleak. In the absence of orders from the SSEB at lower prices than are currently economic the industry has no future. Only Barony does not supply the electricity industry and it is questionable whether the retention of the administrative machinery presently in place in Scotland would be justified even if Barony were profitable. In the context of the Scottish economy the coal industry is now insignificant in terms of value added and employment. However, it is a strategically important sector since it offers the certainty of energy supplies over the long-term. The important point about the SSEB's requirements and the additional cost-cutting impetus from the prospective privatisation of coal is that they reveal the absence of any coherent energy strategy for Scotland and the UK. Privatisation may or may not be desirable. What is essential, however, is that the economy can depend on the provision of energy from a diverse range of sources.

Awaiting privatisation, the two electricity boards reported losses for the year to the end of March following exceptional charges related to the nuclear industry. The SSEB lost £69.4m while NOSHEB incurred losses of £10.2m. These arose because of a once-off payment by the SSEB of £55.9m as its share of the costs of the premature de-commissioning of the BNFL nuclear station at Chapelcross. In addition, the Boards shared a £38.3m charge for the revised cost of nuclear fuel re-processing, incorporating a backdated payment of £13.6m. These charges are related to the forthcoming privatisation in the sense that the charges and changes to accounting procedures have been made now to protect investors from future losses. The key financial issue still outstanding is that way in which the Boards' joint debt of around £2.5bn will be treated.

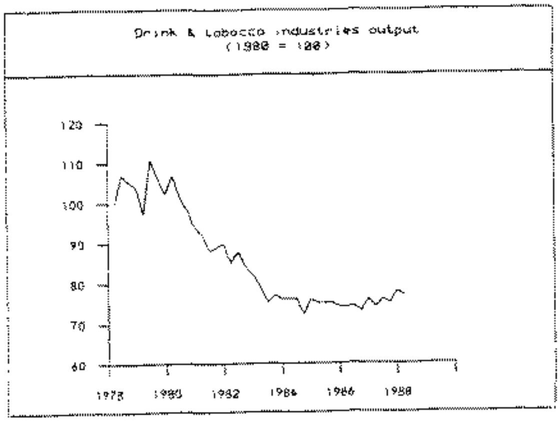
Manufacturing

FOOD, DRINK & TOBACCO

The latest index of production figures give no indication that either the food or the drink and tobacco sectors are moving out of their prolonged recession. The first quarter index for food was 101 (1980 = 100), very much in the line with recent performance. Indeed, the index of production for the food industry has scarcely altered since 1980 and continues to lag slightly behind its UK counterpart.



The index for drink and tobacco was 77, also very much in line with the sector's performance since 1983. The UK index regained its 1980 level by the end of 1987, but the Scotish index remains far short of its 1980 level.



The most significant event of the last quarter has undoubtedly been the bid by Elders IXL for Scottish & Newcastle Breweries. Elders' bid values S & N at £1.6 bn, and was immediately rejected by the S & N board as being unwelcome and putting too low a value on the company. There is, of course, a certain irony in the board of S & N taking this view, since in 1986 S & N attempted to buy Courage (with which S & N would merge under Elders' plans) but was beaten to the punch by Elders' after that company had abandoned its bid for Allied Lyons. The proposed merger between

Courage and S & N at that time was seen as having "sound commercial logic", largely because Courage's strength in the beer market in the south of England would marry well with that of S & N in the north and Scotland. The S & N directors have been quick to point out that the Elders bid is very different from what S & N had in mind two years ago, involving for example the disposal of the Thistle Hotels chain and an uncertain future for many of S & N's tied houses. The irony persists, however, especially because S & N has largely grown by acquisition and was very much portrayed as the rapacious acquirer during its takeover of Matthew Brown.

While the bid by Elders had been expected for some time, its timing does seem rather odd. Elders may have felt that they had to attempt to buy S & N before the Monopolies & Mergers Commission (MMC) completed its inquiry into the tied house system among the major brewers, because this inquiry may indicate that the MMC would regard any further concentration in the beer market as undesirable, expecially because of its highly vertically-integrated structure. If this was Elders' view then they must have been gambling that their bid for S & N would not be referred to the MMC and that the takeover would be quickly completed. However, this was always a high-risk strategy, not least <u>because</u> of the MMC inquiry which is already taking place. It would have been very odd indeed if the Office of Fair Trading had waved through a bid which, if successful, would have substantially increased the overall level of concentration in a market which was already beng investigated at least in part because of the suspicion of detrimental consequences arising from the existing level of concentration. Despite this, Lord Young, Secretary of State for Industry, apparently said he was "surprised" at the Director General of Fair Trading's recommendation that the bid should be referred to the MMC on competition grounds. Given the analysis above, it is surely rather more surprising:

a) that Lord Young should have been surprised at the recommendation; and

b) that he should have readily admitted this to a Sunday newspaper

Neither of the above helps to give any credence to the Government's policy on mergers which now gives all the appearance of being a shambles.

Nevertheless, the decision to refer the bid to the MMC was undoubtedly correct, and not just on the stated grounds of the possible effects on the UK beer market. Recent research carried out by economists at Strathclyde University* indicates that while Scottish companies acquired by non-Scottish concerns frequently benefit, there are serious potential problems in the process for the wider regional economy which are sufficiently widespread and pervasive to justify concern for "the public interest". The correct forum for debate where matters of the public interest are at stake is certainly the Monopolies & Mergers Commission, and indeed the MMC is obliged to consider the likely regional impact of any proposal merger which it investigates. Elders have to some extent tried to head off the objections of the "Scottish Lobby" by promising to site some form of headquarters in Edinburgh. The MMC is not in the habit of accepting uncritically the claims of either party in a contested bid, and it will be interesting to see what assurances the Commission will seek from Elders on this and other promises made at the time of the bid.

In the meantime, the aftermath of the referral has led to some red faces in official circles. Bidding companies are expected to cease purchasing the shares of the target company as soon as a bid is referred to the MMC. Elders did not do so, on the grounds that there was no legal obligation to act in this way, and were able to quickly purchase a further 9.5% of S & N's share capital before being ordered to stop. Since the DTI has now said that it will not attempt to "unscramble" these share transactions, Elders goes into the MMC investigation holding 23.6% of S & N, not the 14.1% which Elders controlled when the bid was announced. This, of course, gives Elders a running start to gain control of S & N if the MMC clears the bid (the decision is expected around March). While this share purchase operation has been seen by some as a shrewed move on Elders' part there must be some question as to how wise it is to deliberately embarrass the Secretary of State for Industry at a sensitive time. However, the Elders' action does have the wider merit of exposing to ridicule the procedure previously in use during takeover bids which relied heavily on gentlemanly behaviour from the firms concerned.

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* "The economic effects of the inward acquisition of Scottish manufacturing companies 1965 to 1980", ESU research paper no 11, 1987.

All concerned must now await the verdict of the MMC, but before ending this section it may be worth quoting two parts from the conclusions of the MMC report on the proposed takeover of Matthew Brown by S & N (Cmnd 9645). Although allowing the bid to proceed, the MMC did make some points about further concentration in the UK beer market. First, referring to the findings of the Price Commission in 1977 that a combination of high concentration and vertical integration had led to upward pressure on prices, the Commission notes:

"We accept that these are the likely consequences of high concentration and vertical integration, and that the maintenance, and if possible enhancement, of competition to the major national tied estate brewers and the prevention of further concentration are therefore matters of concern to the public interest" (Para 7.14, emphasis added)

And later:

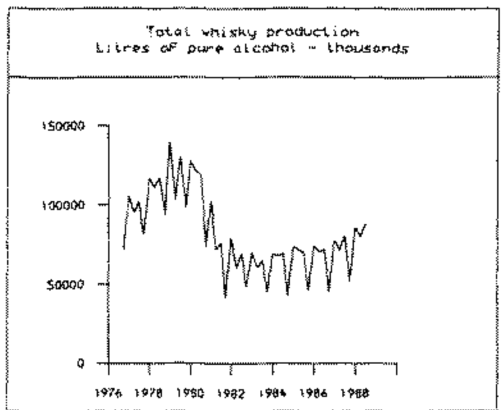
"There may well be a strong case on public interest grounds against acquisition of a regional brewer by any of the five largest national tied estate brewers ..." (Para 7.16)

Unless the Commission has markedly changed its views in the three years since the above remarks were published Elders may well feel that there is cause to be anxious about the Commission's decision.

In the last Commentary mention was made of the purchase of James Keiller & Son's marmalade interest by Rank Hovis McDougall from owners Barker & Dobson. In October B & D virtually moved out of the food and connfectionery manufacturing business by selling its entire sweet manufacturing operation to Alma Holdings of Kirkcaldy for £17m. Alma have thus acquired a company nearly twice their own size, and will now have a total workforce of 1100. This move is very welcome for a variety of reasons. First, it confirms Alma as one of the most successful and fastest growing companies in the UK confectionery market. Second, the takeover should lead to new investment at Keiller's plant in Dundee with up to 100 new jobs being created by the end of 1989. Third, and more generally, it is a welcome change from news of ownership and control of Scottish companies moving out of Scotland. As indicated earlier in the section on S & N, there are genuine concerns about the long-run impact of the loss of control of major companies: nevertheless, it has been stressed on more than one occasion in the pages of the Commentary that takeovers are a two-way process, and any consideration of the net effect of acquisitions on the Scottish economy must consider the takeover by as well as of Scottish companies.

WHISKY

Sales trends in Scotch whisky continue to make fairly encouraging reading. While the home market remains fairly flat, exports continued steady growth in the third quarter of the year. Total exports for the nine months to September were 171 million LPA, 2.6% higher than the same period in 1987. All sectors of the market experienced some growth, including the vitally important bottled-in-Scotland blends. This is the fourth consecutive year of volume export growth over the first nine months and the whole attitude of the whisky sector shows more optimism than at any time for several years. Rising prices as well as rising sales volume seem to be convincing many commentators that the industry's revival in fortunes is becoming fairly robust, and apparently significant progress over entry to the Japanese market (see previous Commentaries) is helping to boost the overall feeling of renewed confidence.



The main news in the whisky sector concerns the change in ownership of two important companies. For one, this represents a return to Scottish ownership from English control, while for the other control remains external. The latter of these is Whyte & Mackay, which is to be sold by Lonrho to Brent Walker for £180m. Brent Walker is principally a leisure group, but has recently moved into pub ownership and clearly sees commercial logic in the new acquisition. The purchase price includes Lonrho's two French wine companies. No immediate changes are expected in the Whyte & Mackay top management (who are reported to welcome the deal) and the company's head office is expected to remain in Glasgow.

Events have moved rapidly at Whyte & Mackay since it took control of the UK marketing rights for several of DCL's brands during the latter's acquisition by Guinness. These included Buchanan and Haig (about to be relaunched in a new bottle and a new label in the hope of recapturing old glories), and since then Whyte & Mackay has gone on to secure other important brands such as the UK rights for Jim Beam bourbon, Camus Cognac, and more recently the brands Wyborowa vodka and Four Bells rum. Just days before the news of the Brent Walker takeover was revealed, Whyte & Mackay announced the agreed acquisition of William Muir (Bond 9), the largest independent blending and bottling company in Scotland. Interestingly, Whyte & Mackay plans to move the international bottling contract for Four Bells rum to Leith from London, an unusual example of external acquisition resulting in production moving to rather than from Scotland.

For several years there has been speculation that at some time Hawker Siddeley might wish to dispose of its indirect 64.6% shareholding in Invergordon Distillers. Continual assertions by Hawker Siddeley management that they were happy with the investment did nothing to stop the rumours. At long last it has emerged that Invergordon will indeed have new owners - the company's own management. At the begining of November DMWS 99, the company formed to make the management buyout, gained control of Invergordon. There had been fears that the bid woud be topped by a third party, but no such development occurred. Invergordon owns seven malt and one grain distillery, and is expected to earn around £7.5m in profits this year. This move of a company back into Scottish control is, of course, very much against the recent trend in the whisky industry. The Invergordon deal is, however, the second such buyout this year. In the early part of the year Inver House Distillers was the subject of an £8m management buy-out from US parents Publicker Industries.

Two and a half years ago an article in Scottish Business Insider indicated that Suntory of Japan were expressing an interest in the Scotch Whisky industry and might be interested in establishing close links with one or more producers. (Suntory used to have a more direct interest in Scotch via a stategic shareholdig in The Glenlivet Distillers before that company was acquired by Seagram in 1978). Suntory has now gone far beyond that modest ambition and has signed a joint venture agreement with Allied Lyons which gives the British company a 1% stake in Suntory. This gives Allied Lyons a head start if and when the Japanese market is further opened to whisky imports, and both Ballantine's and Teacher's should be well-placed brands. For Suntory the inclusion in its portfolio of a number of premium foreign brands (not just whiskies) should help to halt a steady decline in their share of the domestic Japanese market. This is yet another indication of the increasingly international nature of the largest producers in the market for alcoholic drinks, and the fact that Suntory is willing to give up even a tiny fraction of its share capital to a foreign company indicates the seriousness with which it is taking the alliance.

On a somewhat more modest scale comes news of another partnership, this time between two of the leading independents in Scotch Whisky. Lang Brothers and Macallan Glenlivet will form a jointly-owned sales and marketing company on January 1 to handle their portfolio of brands such as The Macallan and Glengoyne (both malts) and the blended whisky Langs Supreme. This agreement is very much in line with the recent trend towards producers exercising closer control of the sales of their products, either by purchasing the agent concerned (as was done recently by Guinness) or as in this case forming a company to do the job in place of an existing agent. The Macallan Langs Partnership will now look for non-whisky drinks to add to its portfolio and may expand its operations into England if it is deemed necessary.

Lang Brothers is a subsidiary of Robertson & Baxter, which in turn has complex cross-shareholding and trading links with Highland Distilleries. By coincidence, just before the new parnership was anounced, Highland unveiled healthy figures for the year to August. Turnover rose by 21% to £122m and pre-tax profits were up to 18% to £14.2m. Sales showed healthy growth both at home and overseas. Export sales rose by one quarter during the year, and now account for 30% of total sales of the Famous Grouse. This brand's share of the UK market has now risen from 10% to 11%.

METAL MANUFACTURING

This quarter brought the issue of the Pathfinder prospectus for the British Steel flotation and the announcement of an offer price of 125p per share. The former indicates an expected net profit for the current financial year of £550m. City estimates are invariably closer to £600m. Thus, in the short term, the prospects for BS are unanimously considered to be good. Initially, the announced price was universally believed to be low and much talk of 'a rock bottom situation' and 'a tremendous bargain' emanated from the financial community. The aftermath of the announcement of the October trade figures has injected a note of caution that small shareholders should heed. On the basis of the current information set, 'stagging' the issue still appears to be a rational response. However, there is a growing body of opinion arguing that world steel demand is nearing the top of the cycle and that a downturn in activity is highly likely. In this view, the early part of the next decade will be characterised by lower demand and weaker prices. It should be noted that BS would appear to be better placed than most to ride out a recession but that its competitive position is vulnerable to adverse exchange rate movements of the pound against major continental currencies. The Chancellor's interest rate policy appears to be designed to induce such movements. In addition, because of the competitive structure of EEC domestic steel markets, the extent to which the UK industry could continue to build up its European market share in the face of a significant decline in steel demand on the continent is unclear. Such issues contribute to a highly uncertain outlook for BS over the coming period. This has prompted analysts to forecast that net profits will halve from the current anticipated levels of circa £600m p.a. in the early 1990's. Thus, most small investors who participate in the issue should not view the share as a long term savings instrument and should take their profits well within the first year.

The flotation price values BS at £2.5bn. This may or may not be low but it is consistent with the market capitalisations floated by analysts and commentators during the last quarter. It is not surprising that the City initially referred to the issue as tbe 'sale of the decade '. Such signals serve to attract marginal small investors from the 1.5 million agents who have expressed an interest in the issue thus engendering a potentially large set of fees when they sell up as it would appear prudent so to do. Further, a good premium would ensure that the privatisation programme remains firmly on the rails thus increasing the likelihood of future lucrative work for City institutions from the sale of the power stations and the water works. A steady flow of such income is required to support the excess supply of financial services which emerged prior to 'Big Bang' and which still endures. The success of this flotation is of critical importance to both Government and the financial sector and although little was left to chance, the risky environment has asserted itself at a particularly unfortunate time.

In Scotland, the issue has engendered a great deal of discussion about the fate of Ravenscraig within a private sector British Steel. Tbe consensus view is that privatisation weakens the position of the Motherwell plant in the medium term and makes it more likely to be closed if BS experiences market difficulties. The detailed case has been set out in previous Commentaries. British Steel has a viable financial strategy to insulate the bottom line against bad times through withdrawal from one or more of their 5 integrated sites. Arthur Young have estimated that withdrawal from Motherwell would increase profits by £100m p.a.. However, this locational upheaval need not result in loss of sales volume. The known and expected investment programme would increase capacity by removing bottlenecks at the remaining favoured locations. The Financial Times has recently suggested that BS would save £80m per annum in operating costs following a site closure. BS has disputed neither the AY nor the FT figures. Whilst contraction would generate exceptional costs in the short run there would be a permanent positive impact on earnings and on the fundamental value of the company. Given the widely held view that the present levels of profitability will not endure, such impacts on earnings become highly significant and may be summoned forth to bolster the equity price. Privatisation compels the BS management to pay attention to the best interests of the shareholder. Indeed, BS Chairman, Sir Rohert Scholey, has repeatedly stressed that tbe present plant configuration is a political structure and that he is fully aware that privatisation effectively removes the political constraint. If the day arrives when it is in the owners' best interests to contract the number of sites, Scholey has made it very clear that wider political and social considerations will carry no weight. All available evidence is that BS regard Ravenscraig as their marginal unit and there are strong grounds for accepting this conclusion. Thus, it is likely that BS is being floated at the very point at which a longer-run perspective, possible in the public sector, is necessary to protect Ravenscraig. Whilst the market may determine the size of BS, the internal dynamic of the business will determine the plant structure. That dynamic is patently loaded against Scotland.

The issue of an independent Scottish steelmaker has also received considerable prominence in the past quarter. In the short run this notion is easily dismissed because BS does not wish to sell its Scottish operation. However the idea has taken root and may re-emerge with greater force because the prospectus is obliged to contain a clause dictating that BS offers Ravenscraig to the market if it should prove surplus to requirements. Given the likely trends in steel demand, the small scale nature of the plant and its peripheral location, it is a moot point as to whether private capital can be induced to invest in an independent Scottish venture. In future, additional sums will be required to modernise the capital equipment and to provide finishing facilities. Clearly a tie-up with a continental producer would obviate the latter consideration, but the attractions of Ravenscraig are such that it is not clear that anyone would wish to substitute Scottish capacity for better located European plant. Such notions may prove enviable in the harsh markets expected in the early 1990's.

At present, there is considerable interest in a technological strategy to secure a medium term role for Ravenscraig within British Steel. This case rests on persuading BS and its owners that it is in their best interests to adopt a variety of process innovations at Motherwell. BS seems set to remain an undiversified steelmaker with both European and, in the long run, global production ambitions. At this time, there are a number of cost saving innovations available at all stages of production and a business with a multinational perspective should be more actively involved in these processes than BS is suggested to be. It is argued that BS should use Ravenscraig as a site on which to develop and experiment with such processes, thus perfecting them and gaining experience with them prior to installation at other sites. One such innovation is thin slab casting (TSC). This technique produces very thin slabs which require less processing at the hot rolling stage. In effect, TSC eliminates the need for a full-blown hot stripmill. This process is operational in both Japan and the US and seems set to become mandatory for competitive stripmaking in the 1990's. TSC saves energy costs, lowers the minimum efficient scale for stripmaking and lowers barriers to entry because the process offers lower capital costs than the huge sums needed to set up a conventional integrated plant. If adopted at Ravenscraig, TSC would result in lower costs per tonne and would offset the perceived cost penalties of a Scottish location. Indeed, such an outcome could restore the situation prevailing in the early 1980's when Ravenscraig's technological advantage sustained it in the face of pressure from larger, more optimally located and laid out sites. Whilst this view has attractions, it should be borne in mind that BS could adopt this technology at another site and still benefit from Scottish withdrawal. If the market turns down as expected there will be considerable spare steelmaking capacity at other plants which could be used to gain experience with this technology. Clearly, TSC would make a separate Scottish entity more credible.

BS has indicated that there will be a thorough review of the stripmaking operation in 1989. This will give the exponents of the new technology school an early opportunity to press for TSC at Ravenscraig. TSC can only be installed at Motherwell if the present hot stripmill is dismantled and removed and would result in fewer jobs in the modernised operation. The STUC has estimated the costs of modernising the existing mill and this case seems set to be advanced. The mutually exclusive TSC option should be pressed simultaneously.

The full implications of TSC have not been fully established. However, this technology appears problematical for Llanwern. In recent years Llanwern has derived strategic favour because of the layout of the works which facilitates the efficient throughput of materials. However, TSC forces efficient throughput on the melting, casting and hot rolling stages of production and much of the benefit of optimal layout in a conventional mill is eroded. For this reason we would take issue with the widely canvassed view that, if BS is forced to concentrate at 3 sites, the second marginal location is at Scunthorpe.

Given TSC, we view Llanwern with its smaller furnaces and inland location to be more vulnerable in the long run. Scunthorpe could develop as a flat products works making strip via TSC and becoming the home of the unified platemaking facility deemed necessary by BS executives.

The BS reaction to claims for new technology will provide a clear signal as to whether there is any long-term role for bulk steelmaking in Scotland. At present, there is strong demand for all of BS's product range and all 5 works are operating at maximum rates of manned capacity. As we indicated in last quarter's **Commentary**, a significant proportion is being exported to non-EEC markets where average realised sterling prices are relatively low. However, the prospects for a successful conclusion of the 1989 strip products review will depend more on expected market conditions and the ability of BS to load its 5 plants with good margin business. Although forecasts are not promising it would be better to reserve judgement until market trends become more well defined. Whatever the case, TSC affords a stronger case than claims for investment in the existing mill.

If the reaction is not favourable and BS cannot be more convincing about the long term role of the plant, then urgent consideration must be given to major economic initiatives in the North Lanarkshire area. In fact, it is arguable that greater resources should be concentrated in this area in any case because it is part of the economy with manifest difficulties. Ancillary measures such as the upgrading of the A74 and the provision of fast rail links between the North and the Channel Tunnel would clearly enhance the attractiveness of the area for industrial and commercial development. In addition, further civil service dispersal is being sought and Lanarkshire should be considered for such projects. The notion that SDA initiatives in North Lanarkshire undermine and betray the steel industry is simply untrue. Following privatisation, decisions on steel are wholly independent of the economic and social conditions in the area. Lanarkshire has nothing to lose from demanding greater resources and any offers of major expenditure should be universally applauded rather than treated with suspicion. However, such initiatives should not be represented in any attempt to minimise the severe and painful adjustments which would result as a consequence of steel closure. The new economic activity would result in a pattern of labour demand entirely different from that which pertains in the steel industry and those linked sectors which would contract in conjunction with steel.

MECHANICAL ENGINEERING

Provisional figures released by the Industry Department for Scotland show that the index of output of the mechanical engineering industry stood at 70 in the first quarter of 1988 (1980 = 100). This represents a rise of six points (9.4 per cent) over the preceding quarter and is three points (4.5 per cent) above the level of a year earlier. In the UK as a whole, the index stood at 92, an increase of one point over the fourth quarter of 1987 and six points higher than a year before. Thus, although exhibiting some growth, the output performance of the Scottish industry continues to lag behind that of the rest of the UK.

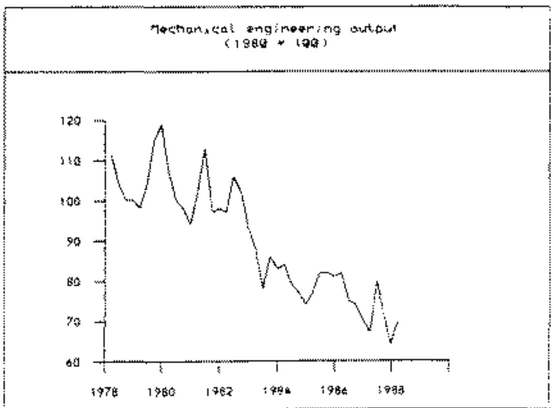
Typically, this section opens with a discussion of trends in the output of the industry. The rationale behind this approach is that these official data on output represent the most important information on mechanical engineering available on a regular basis. Thus, the output figures can be taken to reflect the health of the sector. Although the data are intended to indicate the value added to output in a given quarter, such detailed information is not available. Instead sales are used to proxy value added. This has two main disadvantages. First, the relationship between sales and value added may vary across time, and, secondly, sales will occur in one quarter, while production (and therefore value added) may take place over a number of quarters. This is particularly the case in mechanical engineering where some contracts, such as those for power stations, may be in production for lengthy periods of time. These reservations apply to other sectors to a greater or lesser extent. The concerns with mechanical engineering lie in the considerable revisions which take place between the publication of the provisional figures and subsequent versions. Table 1 presents the published index for the period from the first quarter of 1986. The figure at the top of each column represents the initial, provisional Index of Production, and the bottom row shows the most recent estimates.

Focusing on the data for 1986 and 1987 it is evident that there are cases of considerable variation between the initial figures and the

Table 1 Index of Production of mechanical engineering, 1986 Q1 to 1988 Q1 (1980 = 100)

		1986 Q1	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 Q1
1986	Q1	77								
	Q2	84	74							
	Q3	85	75	75						
	Q4	83	74	73	70					
1987	Q1	83	75	73	72	62				
	Q2	83	75	74	72	63	66			
	Q3	83	75	74	70	64	80	71		
	Q4	82	75	72	69	66	80	71	69	
1988	Q1	82	75	74	70	67	80	71	64	70

latest estimates. In fact, the provisional figures are 3.4 per cent lower than the latest figures, on average. Over the eight quarters of 1986 and 1987 the present estimate is higher than the provisional one in four cases, lower in two and the same in two. The largest amendments occur between the publication of the provisional data and the figure published in the succeeding quarter. Here the absolute average change is 4.7%. Thus, it appears that the provisional figures are an unreliable guide to the performance of the sector. However, in the absence of other official data there is little else which can be used.



The principal reason for these revisions is that the provisional estimates are made with incomplete data sets and as new information comes to light alterations are made. Thus, there is little which can be done to improve the quality and reliability of the provisional estimates and they must, therefore, be treated with some caution.

The Scottish Chambers' Business Survey goes some way to providing an indication of the current health of the sector, asking, as it does, questions about optimism, orders, sales and employment from a sample of firms. The results of the November survey show that the sector remains buoyant with sales, orders and employment all on upward trends.

Table 2 Scottish Chambers' Business Survey - Mechanical Engineering

	% balance - Nov. 1988	- July 1988
Change in optimism	+29	+30
Trend in new orders	+59	+47
Trend in sales	+52	+47
Trend in employment	+59	+27

* The "balance" is obtained by subtracting the percentage reporting "down" from that reporting "up". Firms reporting no change are excluded.

Howden Group has again been on the acquisition trail, this time purchasing Wirth, the West German designer and manufacturer of tunnel and shaft boring machines. Not only does this confirm Howden as an unquestioned leader in the tunnel - boring equipment market, it significantly broadens the portfolio of machine-types which it can supply. While Howden has justly acquired a reputation for supplying machinery to tunnel through soft ground, for example the Channel Tunnel project, Wirth specialises in hard rock tunnelling. Thus, new markets are opened to the Glasgow-based group by this purchase. Furthermore, Wirth has a full order book including contracts for Korea and the Soviet Union which gives Howden further opportunities. Howden will pay Wirth's owners Otto Wolff £9.1m in cash, the money being raised from a £16.4m rights issue. The £7.3m balance will be used in several ways:

£3.5m will be used to purchase a 49 per cent share in Brown Boveri Howden of Canada; £2.3m will be devoted to financing the rationalisation of Howden's North American manufacturing operations; and £1.5m will be used to reduce the company's borrowings. The Group's success also continued in the domestic fan market where NEI International Combustion awarded it a contract to provide two fans and air pre-heaters for the two 900 MW boilers for the Fawley B coal fired power station currently being built by the CEGB.

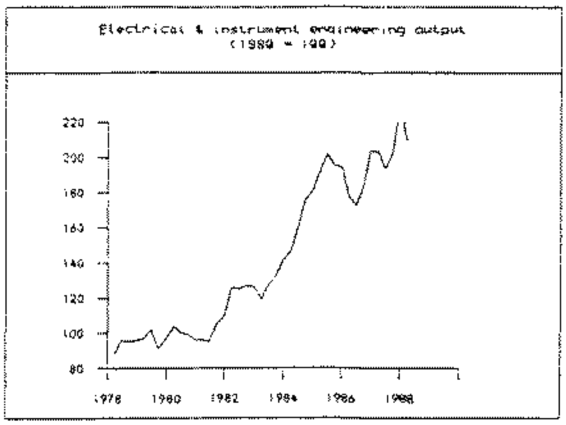
Weir Group, too, has landed some large orders. Weir Engineering of Australia has secured orders worth around £7.5m for the electricity and water supply industries. Nearer home, Weir Pumps will supply water pumping equipment to Ibadan, Nigeria, at a cost of more than £3m. Finally, Weir Westgarth has secured an £800,000 contract for de-salination equipment.

The Department of Trade and Industry's (DTI) bid to sell the National Engineering Laboratory (NEL) appears to have failed. YARD of Glasgow was the preferred bidder but it withdrew in early October, the main reason being dis-satisfaction on both sides about the speed at which DTI funding to the Lab would be reduced. There remain two options: first, the DTI may pursue the privatisation option and offer the Lab to one of the other eight original bidders. Secondly, the NEL may be given agency status. Like the DTI's three other research labs, and would therefore be run by a board of civil servants and others and be subject to a tight budget constraint.

There have been three developments which will affect those parts of the industry involved in the supply of electricity generators equipment. First, revised forecasts of electricity demand mean that the UK will require an additional 15,500 MW of generating capacity by 2000 when the retirement of old capacity is taken into account. This compares with the previous forecast of an additional 12,000 MW of capacity. The solution envisaged is the construction of a further pressurised water reactor (PWR) nuclear station since this would enable the privatised industry in England and Wales to meet its target of generating 20 per cent of its output from non-fossil sources. Although it is uncertain that further nuclear plant will be installed after privatisation, the fact that extra capacity is required will be welcome news for the likes of Weir, Howden, FKI Babcock and Parson Peebles. Secondly, a joint venture between the National Nuclear Corporation and Westinghouse - the American firm which licences PWR technology - has been established to build further PWR's in the UK. Again, firms such as Weir are the likely beneficiaries of any orders secured by the new firm, PWR Power Projects. Finally, in advance of the granting of planning permission, the CEGB is placiog £17m worth of orders for the Hincley C PWR.

With the short-term outlook for the McDermott fabrication yard being bleak, the news that BP Exploration is to place orders worth £150m for development of the Miller field is of some consolation. The orders will include a 16,500 tonnes platform jacket and a 6,500 tonnes module support frame. Both McDermotts and Highland Fabricators will be seeking this work as well as RGC and the English yards.

ELECTRICAL & INSTRUMENT ENGINEERING



The provisional index of production for Electrical and Instrument Engineering stood at 209 in the first quarter of 1988(1980=100).The 15% rise in the final quarter of 1987 seems therefore to have been at most a hiccup, and indeed the figure will probably be further revised downward. Overall, the industry recorded a very modest 3% growth in output in the year to the first quarter of 1988.

Predictions of continued strong growth in the demand for semiconductors (see the last issue of this Commentary) appear to have taken something of a knock with the publication of sales and order data by the Semiconductor Industry Association. The ratio of new orders to shipments fell to a three-year low last month, with the major reason being a straightforward decline in orders from the major manufacturers, especially in the personal computer market. A report by Motorola also confirmed that slower market growth in PCs is is expected to reduce the growth rate of the European market to 11% in 1989, compared with 25% this year. However , some levelling of demand is probably to be expected as the first wave of new generation PCs has worked its way through the market. Growth rates may now begin to stabilise at around the 10-11% mark. Motorola expect the UK market to grow at a rate of around 13-14%, with this higher rate due to the concentration of many of the largest companies here, many of course in Scotland.

The state of the industry in Scotland has recently been investigated in a major new report, the SDA's Electronics Industry Database. As well as confirming some known features about the industry,it threw up some interesting new findings. Electronics' importance to the Scottish economy (16% of all manufacturing sales and 12% of manufacturing employment) and its high export orientation (two-thirds of all output is exported, half to the EEC) were confirmed by the study,and the industry continues to grow rapidly. A 1986 turnover of £2.6Bn grew to £3.6bn 1988. In addition,there appears to be a growing incidence of R & D applications and employment in Scotland. Graduate and Technician employment now accounts for over 11,000 jobs , 25% of all jobs, a figure which compares very favourably with the 20% of jobs in this category in 1986.

What remains depressing, however, is the performance of the linked indigenous sector. Only 15% of purchased components were sourced in Scotland. Recent evidence (see QEC February 1987) makes it clear that this is the fault of the quality of work in the indigenous sector, and is not due to some spatial bias on the part of the foreign sector. A new SDA initiative to set up two new indigenous supply companies will help (as will, eg the formation of the Just in Time Club) but clearly there is still a very long way to go.

The survey also noted a facet of the foreign sector which continues to cause concern. While the increased intensity of R & D at plant level is to be welcomed because of the enhanced security it will undoubtedly bring, the lack of in situ marketing functions indicates that few Scottish subsidiaries are able to develop their own lines of business, and must therefore remain to some extent dependent on allocated growth. Only 5% of all graduates in surveyed firms worked in marketing functions.

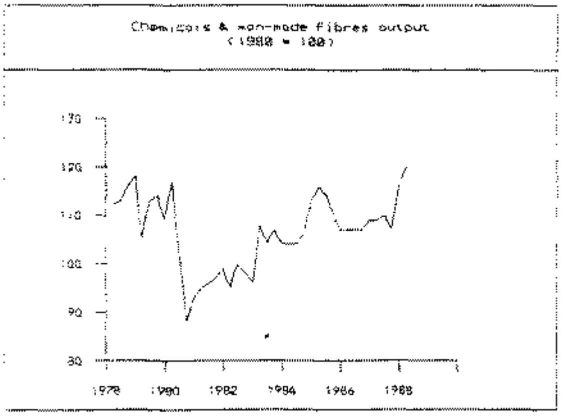
The most dramatic finding if the survey is the growing importance of the Japanese presence, especially in semiconductors and consumer electronics (recent issues of this Commentary contain details of the major recent Japanese investments in Scotland). Little research has so far been done on Japanese industry in Scotland, but there is a suspicion that many Japanese direct investments have been made to avoid tariff barriers , or the threat of these. So-called "screwdriver plants " (restricted to assembly operations, having little devolved authority and relying heavily on components imported from parents) may result. As noted, it is not known how closely this model applies to the Scottish case, but the SDA survey found that sourcing from Japan had increased from 8% of the total in 1986 to a massive 30% this year. With the SDA currently targeting Japan as a source of new inward investment projects, this problem is likely to increase in the near future. Perhaps a more important issue, however, is whether a greater Japanese presence will endanger the long term strategy of developing the indigenous sector.

The influx of foreign industry into Scotland continued with the decision of Sun Microsystems to set up an £11.M plant at Linlithgow to produce workstations while larger inward investment projects have been seen in Scotland. The importance of this project is that Sun is currently the world's fastest growing computer company, indeed it is probably the world's fastest growing company. Formed in 1982, sales in 1988 are expected to top $1bn. Europe accounts for one quarter of that, hence the decision to expand here. It is undoubtedly of great importance to Scotland that Sun had chosen to locate here. Three hundred jobs are expected to be in place by 1991.

CHEMICALS AND MAN-MADE FIBRES

The Scottish index of industrial production for this sector in the first quarter of 1988 stood at 120 (1980 = 100). This represents a growth in output of 3% over the previous quarter. Comparing the latest four quarters with the preceeding four, reveals that output in this sector has grown by 5% in Scotland compared with

6% for the UK as a whole.



Responses to October's Scottish Chambers' Business Survey show that 100% of responding firms were as optimistic about the general business situation in the Chemicals and man-made fibres industry as they had been three months previously. 32% claim to be more optimistic. Increases in new orders and sales anticipated for the three months to October were not fully realised with only 32% of respondents experiencing increases in these areas. Despite this, the expected trend over the next quarter in the volume of new orders and sales is more optimistic with a balance of 32% of firms anticipating new orders, while a balance of 51% expect increased sales. The trend in employment in this sector over the last three months improved slightly with a balance of 7% of firms reporting that employment had increased. Total employment is expected to remain stable over the next three months to January.

This sector has continued to attract major investments. In September BP announced its intention to spend up to £300m to expand its gas processing plant at Kinneil, near Grangemouth. The project would double the size of the plant near BP's petrochemical complex and refinery, and would provide around 1,000 jobs in a three year construction phase. This expansion would increase liquid petroleum gas handling capacity by 100% and is expected to create 30 permanent jobs at Kinneil.

BP Chemicals, a subsidiary of the UK oil group, plans to invest up to £200m in adding significantly to Britain's capacity to make ethylene, a vital feedstock in the chemicals industry. The expansion would go ahead at an existing BP Chemical plant at Grangemouth, and would double ethylene production at the site which currently produces around 270,000 tonnes of the material a year.

BP Chemicals, western Europe's second biggest producer of ethylene after Shell International Chemical, hopes to make a final decision next year on whether the new investment in Scotland would go ahead.

Most of the new capacity, which would increase the UK's current ethylene production of 1.9m tonnes a year by about 13%, would be channelled directly to feed other plants run by BP Chemicals at Grangemouth making polythene.

Scott and Robertson have acquired Calnay, a producer of agricultural, horticultural and building film, from CH Industrials in a £2m deal. The Scottish-based buyer reported that the acquisition would give it a base for expansion in Wales and the south of England, where it will become one of the leading suppliers of damp-proof membranes and temporary protective sheeting.

The announcement by Royal Ordnance, part of British Aerospace, to rationalise its explosives, propellants and ammunitions factories is expected to involve plant closures and redundancies among the 13,000 Royal Ordnance staff.

The move which is designed to cut costs and provide the Ministry of Defence with cheaper products over the next five years, centres on explosives factories at Bishopton, near Glasgow, and Bridgewater in Somerset. Following a meeting this month with TGWU leaders representing the workforce, Royal Ordnance has agreed to postpone until January plans to transfer production from the threatened plants. During this two-month period public investigations into the strategic and financial implications of the closures will take place.

TEXTILES, FOOTWEAR, LEATHER & CLOTHING

The latest Index of Production figures suggest that there are some encouraging signs in this sector with output rising by 2 points to 107 (1980 = 100) between the third quarter of 1987 and fourth quarter of 1988. The Index of production for Scotland is now standing at its highest point since the 1970s and is equal to that of the UK figure. Compared to one year earlier, the Index is now 11 points higher. The comparison of the latest four quarters indicates that there has been an increase of 5% in Scotland compared with a 2% increase in the UK as a whole. Thus, with this improvement in its output performance, the Scottish industry has equalled the level of output performance to the UK for the first time since 1981.

Table 1 Scottish Chambers' Business Survey - Textiles, Footwear, Leather and Clothing

	% Balance	
	Oct 1988	July 1988
Balance of Optimism	-2	-10
Trend in Orders	+21	+46
Trend in Sales	+23	+31
Trend in Employment	+15	+25

In October, the Scottish Chambers Business Survey noted that a balance of 2% of firms were less optimistic about the general situation in this sector, than was the case in the previous Survey (Table 1). The uncertainty revealed by the previous survey would appear to have been justified; although the trends in employment, sales and orders are still on the upwards, they are less so than in July. The expected trends for sales and order, according to the Survey, remain upwards. However, the expected trend in employment over the next three months is downwards with 11% of respondents expecting the trend in employment to decrease.

The balance of trade for the UK in this sector showed a marked deterioration during the first half of this year. Imports increased by 12% to £3.4 bn and the textile sector experienced a fall in output. Exports, did rise, although only did so by 4% to £1.7bn. The British Textile Confederation claims that a combination of high interest rates with a high pound has led to a period of uncertainty for the industry. The pound's strength against the dollar has meant an increase in imports from the Far East. The Confederation, according to its president Barry Spencer also fears that high interest rates could act as a disincentive to investment.

The Textile industry in the Borders is continuing to decline due to the slump in demand for Shetland wool. There have been a series of redundancies over the past three months. Laidlaw & Fairgrieves, who are part of the Dawson Group announced the closure of their spinning mill at Walkerburn with the loss of 212 jobs. A further 26 redundancies were expected at the Group's Selkirk dye works and also 10 service jobs at their headquarters in Galashiels.

More encouraging was the news from a firm, Gleneagles Club Sweaters, who specialise in adding emblems, embroidery and applique designs to textile products. They have bought a nearby firm called Scotcrest of Bandeath; they also have plans to open a new plant at Barnsley in Yorkshire. The expansion plan includes the installation of computer equipment at both plants costing around £250,000.

On 5 October, it was announced that Gardner of Selkirk who make woollen fabrics and yarn was bought by Yorkshire based S. Jerome & Sons (Holdings). The package includes an expansion programme through the issue of shares.

PAPER, PRINTING AND PUBLISHING

Latest provisional index of production statistics suggest that Scottish output in this sector grew by a sharp 6% between the final quarter of 1987 and the first quarter of 1988 to reach an index value of 120 (1980 = 100). The equivalent UK quarterly growth rate was 5%, to also attain a first quarter index value of 120.

The responses to the October SCBS for paper, printing and publishing indicate, as had been predicted in July, significant third quarter increases in both new orders and sales (reported by net balances of +65% and +61% of respondents respectively). Unlike the experience in the second quarter, net rises in orders and sales were recorded in all markets; Scottish, UK and international. Further growth in orders (net +24%) and sales (+23%) were predicted, though at a much more modest level on balance.

In spite of actual and expected increases in orders and sales, total employment in paper, printing and publishing fell between July and October (net balance of -27%) and is forecast to decline further in the fourth quarter (balance of -6%).

Lack of capacity was reported to be the major constraint to growth by 33% of October respondents, reflected in the fact that a net +36% of establishments had made upward revisions to their intentions to invest in plant and machinery. However, the heterogeneous nature of this sector is illustrated by the fact that 21% of respondents felt that lack of orders or sales was the most important handicap to short-term growth.

TRANSPORT EQUIPMENT

A £57Mn contract for Caledonian Airmotive of Prestwick to overhaul and repair jet engines for Canadian Airlines International is expected to create at least 150 jobs over the next few years, bringing total employment to 650. And there is the possibility that more orders will follow , as the Canadian firm is expected to purchase more jets. At present, CAI has ten jets, and is poised to purchase a further three, and to take options on eight more.

Elsewhere in the air sector, the American Airlines purchase of fifty Boeing 747s , to be powered by Rolls-Royce RB-211s, is expected to secure work for the 5000 employees at Hillington until at least 1991. The £1Bn contract is the largest in the industry for many years, and Hillington is scheduled to make the compressor blades. More good news for Rolls-Royce is that the East Kilbride plant has secured an order to overhaul the 80 Spey engines of British Airways BAC-111 fleet.

The short term future of the Hall-Russell yard in Aberdeen presently lies with the ODA and their willingness to provide some sort of support to see the completion of the St Helena ferry, due in late 1989. Otherwise the 435 jobs seem certain to go, the receiver having been called in. The management have, however, been having talks with a foreign buyer for some months, but there are no reports about any definite bids for the yard.

Services

FINANCIAL SECTOR

The alliance between the Royal Bank of Scotland and Banco Santander of Spain places the implications of 1992 for the financial sector firmly on the agenda. The European Commission wants the governments of the EC to dismantle controls on capital flows and financial services. Existing regulations on both banks and other institutions which prevent them from offering services across borders unless they are established locally and comply with regulatory requirements would be removed, and institutions operating in one country would he free to operate in the others. It is doubtful whether the Commission's dreams will be realised by 1992 but fundamental forces are acting to open up European financial markets to a degree that could scarcely be contemplated a few years ago. The liberalisation of security markets that has followed in the wake of the changes in London point to tbe power of competitive markets in promoting change. Few governments will willingly stand by and watch business and profits ebb away to another financial centre. Liberalisation is a price that is paid, perhaps not too willingly, to retain financial capacity and expertise. Many of the changes in attitude and regulation are too minor to be extensively documented but the overall impact is a gradual opening up of European financial markets and opportunities. Inevitably, the process of financial integration must lead to a conflict of ideas and institutions as different financial traditions meet in the market place and fight for business. How the market will be organised is difficult to predict but on present regulatory trends relationships between firms and banks are likely to be much more open and competitive in most of Europe than has typically been the case.

British banks stand to gain from the opening up of competition. Due to the concentration of foreign banks in London they have already experienced the full force of banking competition. They have learnt that in retail markets an established branch network is an important ingredient of success. The inability of any of the America banks to successfully break into the UK retail market has shown that to he successful there is a need for local offices with a developed client base although as the Bank of Scotland has demonstrated with its expansion in the South of England, there is scope for niche players specialising in particular sectors of the market.

In the corporate market the UK banks have faced intense targeted marketing with facilities such as term loans being offered by their competitors to important clients at low margins and attacks on all the more profitable segments of the market.

They have lost significant and profitable sectors as industrial and commercial companies became more aware of what was possible and could be achieved, but despite such losses they have fought back by adapting their product range and playing to their strengths in particular sectors of the market. Many of the European banks are only at the beginning of this learning curve. Their experiences of international competition within their own markets has been relatively limited, and whilst they adjust to the changed market conditions and increased competition in their home markets they are likely to lose some profitable areas of business.

Within this framework it is of interest to consider the relative merits of the alliance between the Royal Bank and Banco Santander. The alliance gives the Royal Bank access to a small but growing European network since Banco Santander has recently acquired branches in West Germany by purchasing Bankhaus Centrale Credit and in Belgium, Credit du Nord Belgica. Under the agreement these branches will be jointly owned by the two banks.

The alliance consists of an exchange of two and half per cent of each others equity plus the further purchase by Banco Santander of two and half per cent of the Royal Bank's equity from the Kuwait Investment Office. Banco Santander is largely family owned. In the longer term if the alliance is to be effective it must lead to a merger or more extensive equity sharing. It is difficult to see in what way potential conflicts in objectives and policy can be resolved within the present limited agreement. The alliance will function so long as both banks are moving in the same direction, but it is unlikely to survive in its present form any substantial differences in approach. The logic behind the alliance is the limited resources of the two banks individually. Neither is large enough to establish quickly an effective presence in the majority of European markets. The alliance eases this difficulty and, by co-operating, enables them to provide a wider range of services to customers. However, they remain two separate banks predominantly based in Britain and Spain with limited coverage in the rest of Europe and potential problems of conflict arising from two centres of control. The alliance illustrates one way of exploiting the potential benefits of European integration but it is as yet a largely token gesture. To be effective the alliance must keep up the pace of European acquisitions with all the problems that that entails and move towards a closer relationship between each other as well as investigating other possible partners. Alliances involving small exchanges of shares are unlikely to be stable and effective unless they are simply a prelude to a merger or at least much greater integration of activity. It is also not apparent how this alliance bests exploits the Royal Bank's experience in a very competitive market place. Investing in the retail market is expensive and in the current climate of dramatic change and innovation somewhat risky. Targeted marketing in particular profitable areas of the loan market and in specialist financial services would appear to be a more satisfactory method of proceeding.

The maintenance of London's position as the pre-eminent European financial centre is not necessarily a foregone conclusion. The publication of the Institute of Manpower Studies report, financed by the Stock Exchange and a number of large firms, pointed to skill shortages and the requirement for more training if London is to keep growing as a financial centre and not to lose out to other centres. Other pressures, notably the increased probability of successful litigation against inadequately trained advisers and even investment managers and others in charge of portfolios as a result of the Financial Services Act, also point to the need for more education and training. There is little evidence as yet, however, of such increased realisation of the need. Will this be another area in which too little is done too late?

DISTRIBUTIVE TRADES

According to the latest SCBS, Scottish wholesalers enjoyed a buoyant third quarter, with a net 66% of October respondents reporting sales increases. A substantial net majority (+74%) expected further sales growth in the last three months of this year. Not surprisingly, in view of the good performance and prospects, a balance of +40% of October wholesalers felt more optimistic about the general business climate than they had done in July.

Contrary to expectations expressed in July, employment in wholesaling continued to rise in the third quarter according to a net +38% of SCBS respondents. Increases in both full-time and part-time jobs were recorded. Further job-growth in the last quarter was predicted by a significant majority.

Attracting personnel seems to have been less difficult that wholesalers had feared since the proportion complaining of staff shortages fell from 27% in July to 15% in October. However, a significant number (27%) still felt that stock shortages could be an impediment to further short-term growth.

Table 1 shows the geographical pattern of October SCBS wholesale responses. A good third quarter sales performance was enjoyed in all areas, and optimism about future sales prospects was also geographically widespread.

Employment growth seems to have been stronger in Glasgow and Dundee than elsewhere (though it should be noted the October sample in Edinburgh was very small).

Table 1 Geographical response to October SCBS - SCBS - Wholesaling

		Balance of Respondents in:			
		G	E	D	A
		%	%	%	%
Overall Confidence	UP	+72	+29	+22	+30
Actual Sales	UP	+58	+71	+85	+60
Expected Sales	UP	+88	+100	+86	+53
Actual Employment	UP	+41	0	+84	+5
Expected Employment	UP	+17	0	+80	+21
Investment Intentns	UP	+33	+71	-2	+9

Key: G = Glasgow, E = Edinburgh,
D = Dundee, A = Aberdeen

In spite of significant rises in interest rates during the period, retail sales growth in the third quarter continued to be very strong, with a net 67% of respondents reporting increases. Interestingly, however, only +20% expected further short-term sales growth in spite of the forthcoming Christmas period. This is, perhaps, evidence that retailers do expect the increased cost of consumer borrowing to begin to have an impact.

Employment grew between July and October (net +15%) and is expected to increase again in the fourth quarter (net +25%). However, all the future employment growth is in part-time jobs, with full time employment predicted to fall on balance.

Table 2 gives a geographical summary of the October SCBS retail responses

Table 2 Geographical response to October SCBS - Retailing

		Balance of Respondents in:			
		G	E	D	A
		%	%	%	%
Overall Confidence	UP	+16	+1	+6	+26
Actual Sales	UP	+19	+60	+78	+94
Expected Sales	UP	+20	+19	-6	+62
Actual Employment	UP	+26	-15	+3	+24
Expected Employment	UP	+53	-28	+9	+32
Investment Intentions	UP	+3	-33	+5	+59

Key: G = Glasgow, E = Edinburgh,
D = Dundee, A = Aberdeen

Third quarter sales performance was strong in all areas, except Glasgow (in spite of the Garden Festival). However, only in Aberdeen was there consistent evidence of optimism concerning short-term prospects.

TOURISM

Tourism is defined officially to include all business and leisure motivated travel which involves a stay away from home for one night or more. The dominant flow is travel for holiday purposes, and here the statistical convention is to make a distinction between "long" (4+ nights away from home) and "short" (1-3 night) holiday trips.

Over the past decade there has been a pronounced market shift in favour of long holidays taken overseas. Table 1 shows that throughout the 1970's an annual average of 38 million long holiday trips were taken domestically by the British ie were centred on tourist destinations within Great Britain. The comparable figure for the last three years is 31 million - a loss annually of some 7 million long holiday trips. Long holidays overseas by Britons have climbed from a yearly average of 5 million over the period 1965 - 1969 to 18 million between 1985 - 87. Put another way Table 1 indicates that the ratio of domestic to overseas long holiday trips has moved from 6:1 to 17:1.

The declining popularity of Britain as a destination for domestic long holiday taking has hit sectors of Scotland's tourist industry though the impact is difficult to chart in precise statistical terms. The annual British Tourism Survey suggests that while the number of tourism trips by Britons to and within Scotland has more or less held up - at around 11 million per annum - the total number of tourist nights generated by those trips have fallen since the early 1970's (see Table 2). A quite dramatic halving of tourist nights associated with trips for holiday purposes is suggested. Table 2 shows that a modest rise in overseas tourist trips to Scotland has recently occurred but this has been insufficient to offset the overall loss of volume evident in relation to the domestic market.

Arguably what is evident here is a tourist industry losing its former staple as patterns of resort-based seaside tourism and of individual car touring decline. Newer growth markets such as weekend breaks and business and conference meetings are characterised by much shorter length of stay. The implied loss of volume and night is reflected in the Scottish hotel occupancy statistics which indicate a progressive fall in bedspace utilisation since the mid 1970's to reach 38% last year (refer Table 3). It will be noted that this figures is lower than achieved by virtually all tourist regions South of the Border.

Table 1: GB Holidays: 'Long' Holiday Trips (4+ Nights)

Yearly Averages	Home	Abroad
	Mill	Mill
1965 - 69	30	5
1970 - 74	38	7
1975 - 79	38	9
1980 - 84	35	14
1985 - 87	31	18

Source: BTS

TRANSPORT

Air

A new Scottish airline, Scottish European Airways, began operating in mid-November offering direct weekday flights from Glasgow to Brussels and Frankfurt. Services from Edinburgh will start soon and SEA also has plans to extend its network to take in Milan, Copenhagen, Gothenburg, Hamburg and Geneva. At present, the company operates with two 32-seat Boeing 748s , but it is already reported to be considering the purchase of two 747s.

The Brussels route is particularly important because SEA has negotiated a deal with the Belgian airline Sabena which allows Scottish customers to link into Sabena's world-wide computer network and the Glasgow flights are timed to interlink with Sabena's world-wide flights from Brussels, greatly expanding the network of flights available from Glasgow. The new company presently employs 35 people, expected to rise to 85 in the next few years.

Elsewhere in air transport, Air UK began operating the Edinburgh and Glasgow trunk routes to Gatwick which it won following the BA-B Cal merger. The new service will initially operate with two 112-seat aircraft, although Air UK will bring 142-seat 747s into operation by 1991 when demand is scheduled to grow to 200,000 passengers per annum, one third above present levels. So far, the company has spent £30Mn on the two new planes.

The Civil Aviation Authority is to spend £600Mn in the next decade on improving the air traffic control safety system, with £100Mn to be spent in Scotland. Most of this will go to Prestwick which houses the Scottish control centre and the Oceanic centre , responsible with Shannon airport for the Atlantic area. However, some of the money will be used to provide a new radar display system at Glasgow and the control tower at Edinburgh is to be improved.

Rail

Speculation (quickly dismissed by the government as "rubbish") that privatisation of BR would lead to a severe rationalisation of the network have dominated the recent headlines in this sector. The suggestion, in a leaked document, that 1000 miles of track could be closed as a pre-privatisation

Table 2: Trend in Scotland's: Overseas and Domestic Tourism 1972 - 86

	Domestic			Overseas	
	Trips All Tourism (mill)	Nights All Tourism (mill)	Nights Holiday Tourism (mill)	Trips All Tourism (mill)	Nights All Tourism (mill)
1972	12	75	65		
1973					
1974	11	55	45		
1975	10	60		0.9	12.0
1976	11	50	40	0.8	10.7
1977	12	60		1.0	12.0
1978	12	55	40	1.1	12.0
1979	12	55		1.0	12.0
1980	12	55	45	1.0	11.7
1981	12	55		0.9	10.6
1982	12	55	40	1.0	11.4
1983	13	60		1.0	11.5
1984	12	55	40	1.1	12.0
1985	-	-		1.1	13.1
1986	10	45	30	1.3	13.0

Sources: BTS/IPS

NB All figures for domestic trips and night rounded to nearest 1 and 15 million respectively.

Table 3: Hotel Bedspace Occupancies by Locality, 1987 with Bedroom Rates in Brackets

BY GB REGION/COUNTRY	%		BY SCOTTISH DISTRICT/REGION	%	
Cumbria	46	(55)	Dumfries/Galloway	31	(41)
Northumbria	41	(57)	Borders	41	(47)
North West	39	(53)	Ayrshire	32	(43)
Yorks and Humberside	41	(52)	Forth Valley	37	(55)
Heart of England	40	(52)	Loch Lomond, St/Tross	42	(54)
East Midlands	38	(53)	Perthshire	38	(39)
Thames and Chiltern	47	(65)	Rural NE	28	(35)
East Anglia	41	(57)	HIDB area	42	(49)
London	61	(76)	Edinburgh	38	(49)
West Country	40	(51)	Greater Glasgow	41	(56)
Southern	43	(58)	Dundee	39	(52)
South East	42	(57)	Aberdeen	37	(56)
Scotland	38	(48)			

Source: Tourism accommodation occupancy studies of National Tourist Board.

sweetener may or may not be true, but there is little doubt about two points. First, that the government will attempt to privatise BR at some point (the current official position is that the government is considering options for the railways, one of which is a sell-off) and secondly, that some rationalisation will ensue. Given that one major aim of privatisation is to save the taxpayer money, some of this will almost inevitably have to come from rationalisation. Although subsidies have been falling and losses have improved for some years now, the government is committed to pumping over £400Mn into the railways for at least the next four years, a reduction of only £100Mn per annum over the figure for the mid-eighties. It is extremely doubtful therefore whether the blend of productivity improvements, greater rolling stock utilisation, competitive tendering and job losses employed by BR in recent years is itself enough to make the industry attractive to the private sector. The size of the sums involved make it seem unlikely. Either many marginal services will have to go or else the government will be forced to continue to subsidise socially necessary lines. In Scotland, it has been suggested that even major services, such as Aberdeen-Edinburgh, will continue to need public support.

The future shape of a privatised BR is also the subject of speculation. One suggestion is that BR be reduced to a track-owning authority which sells the right to run lines to the private sector, a solution proposed by the Adam Smith Institute. Quite how this avoids the monopoly problem is unclear. Another suggestion is to privatise BR as a single entity, a solution which is not surprisingly supported by the present management. However, the government will probably favour the solution adopted for the buses, breaking the company into small units to promote competition, and the figure of about twelve regional companies has been suggested, returning the industry to its pre-war ownership structure.

Meanwhile the Scottish Office has allocated £29Mn to Strathclyde Region for the purchase of new trains. The Region will use the money to buy 22 new electric and 14 new diesel trains as part of an ongoing modernisation of the local network, which accounts for 40% of the Scottish total.

Roads

The debate over Strathclyde's proposed £274Mn motorway extension continues. In addition to generating a considerable amount of resentment from local residents, the proposals will almost certainly cause the cancellation of a £5Mn investment by Long John International, whose proposed new bottling plant stands in the way of the extension, losing 140 jobs. Jobs would also be threatened at two industrial estates which would also be cut in half by the new road. The Scottish Secretary is expected to announce his decision early next year.

Meanwhile, the CBI in Scotland has expressed its concern that the proposed upgrading of the A74 to motorway status only involves two lanes. It is concerned that if Scottish industry is to reap the benefits of both 1992 and the Channel Tunnel, good communications to Europe are vital. Two lanes will not be adequate, they argue, to cope with expected future traffic flows.

Sea transport

The solution adopted by the Scottish Office in the sell-off of Cal-Mac (which was formerly part of the Scottish Transport Group) is of great interest in view of what was said above in connection with BR. The government has seemingly accepted that most of Cal-Macs existing routes are essentially uneconomic. Only the five Clyde Coast routes (Gourock-Dunoon, Wemyss Bay-Rothesay, Ardrossan-Brodick, Largs-Cumbrae and Colintraive-Bute) are therefore to be offered for sale, with a total of 21 routes (in the Western and Inner Isles) to remain in public ownership. Sealink and P & O are expected to bid for the Clyde routes.

The Labour Market

THE LABOUR MARKET

A Employment: Stocks and Flows

The year to June 1988 saw a small rise, of around two thousand, in the total number of employees in employment in Scotland (Table 1). However, this increase in the number of employees is the net outcome of a fall in male employment of ten thousand and a rise in female employment of twelve thousand. The increase in female employment was predominantly part-time in nature (around 10,000), so, on the (generous) assumption that 'part-time' means 'half-time', and that the loss of male employment represents full-time jobs, full time equivalent employment actually full over the year (by approximately 3,000). The changes over the year to June 1988 are consequently very much in line with longer term trends. Thus, as compared to 1979, the last year which could be regarded as a 'peak' year for employment in Scotland the number of male employees has fallen by over 17%; the total number of female employees is now at much the same level (reflecting an initial decline to 1983 and then recovery); part-time female employment has grown by over 17%; full time female employment has fallen by 11% (from 565 thousand to 503 thousand).

The distribution of employment changes across broad industry groupings is also broadly in line with longer-term developments as inspection of table 1 confirms. Thus an employment loss of around ten thousand (-1.7%) was apparent in the production and construction industries whereas the number of employees in the service industries

Table 1 Employees in employment in Scotland: industry aggregates (000's)

	Male	Female All	Female Part-time	Total	Production & construc. industries	Production industries	Manufacturing industries	Services industries
SIC 1980					1-5	1-4	2-4	6-9
Scotland								
1979 June	1,205	897	332	2,102	831	676	604	1,224
1983 June	1,060	839	337	1,899	646	512	444	1,216
1986 Sept	1,020	866	367	1,886	595	460	409	1,261
Dec	1,006	868	375	1,874	586	451	404	1,259
1987 Mar	997	865	375	1,862	578	442	396	1,254
June	1,006	880	379	1,886	579	441	395	1,277
Sept	1,001	878	383	1,879	577	437	392	1,273
Dec	996	881	389	1,877	572	432	388	1,278
1988 Mar	989	879	387	1,868	570	429	386	1,271
June	996	892	389	1,888	569	427	385	1,292

Source: Department of Employment Gazette, November 1988 and earlier issues.

increased by around fifteen thousand (+1.2%). Since 1979 employment in the production and construction industries has fallen from around 40% to 30% of total (employees in) employment. The service sector has increased its share of employees over the same period from 58% to 68%. However, these compositional changes primarily reflect the absolute decline in employment in production and construction (32%) rather than significant growth of the service sector (5.6%).

Table 2 provides further detail of the industrial composition of employees in Scotland. The major employment losses over the year to June 1988 were registered by: metal goods, engineering and vehicles (4 thousand); other manufacturing (5 thousand); energy and water supply (3); and the only service sector to register an employment loss, transport and communication (3). Employment gains occurred in: wholesales, distribution and catering (10); banking, insurance and finance (4); public administration and defence; and, the only non-service industry to register an employment gain, construction (4). The general increase in employment in the service sector (with the exception of transport and communication) is in tune with longer term developments as is the decline in employment elsewhere. The small upturn in the number of employees in construction is a short-term development dating from 1987.

Overall, the, although a simple 'head-count' might suggest otherwise, recent changes in employment provide few genuine grounds for optimism. Those seeking such evidence can derive some satisfaction, however, from the continuing strength of some service sectors and the recent upturn in construction. Nonetheless, even such moderate grounds for optimism concerning the number of employees as do exist, should be viewed against the contrasting UK background, where, in the year to June, 1988: full time male (female) employment increased from 10,735.4 (5,424.3) thousand to 10,746.1 (5,533.1) thousand, part-time male (female) employment increased form 887.8 (4,277.1) thousand to 937.8 (4,390.1) thousand. Furthermore, the latest figures do not encourage the view that a major stimulus to total employment is likely to by provided by self-employment, although it is the case that this is estimated to have increased from 197 to 200 thousand over the year to March 1988.

Table 3: Vacancies: Stocks & Flows

Vacancies at Job Centres

		Scotland	GB	Scotland as of % of GB
1987	Aug 7	23.4	267.7	8
	Sept 4	25.0	293.1	8.1
	Oct 2	25.4	309.9	7.9
	Nov 6	24.6	301.3	7.9
	Dec 4	22.0	268.6	7.9
1988	Jan 8	20.2	255.0	7.5
	Feb 5	20.5	254.0	7.6
	Mar 4	21.9	260.1	8
	Apr 8	24.2	278.8	8.3
	May 6	24.9	289.7	8.2
	June 3	24.5	296.5	7.9
	July 8	24.6	284.1	8.3
	Aug 5	24.1	267.4	8.6

VACANCIES

Table 3 summarises recent data on unfilled vacancies in Scotland and Great Britain - Vacancies increased by 0.7 thousand in Scotland and fell by 3.4 thousand in Great Britain over the year to September 1988, a change reflected in the increase in Scotland's share of Great Britain vacancies (from 8.16 to 8.4%). Table 4 gives data on the flows into and out of the stock of vacancies. The inflows and outflows were both much the same scale as the stock of vacancies, so that their average duration is only one month.

B. UNEMPLOYMENT: STOCKS AND FLOWS

Table 5 presents recent data on the seasonally adjusted stock of unemployment in Scotland. The figures in parentheses are constructed on the basis of the September 1988 rules governing eligibility to claim for unemployment benefit. The change reflects the recent extension of the guaranteed offer of a YTS place to all those under 18 who have not found a job, under the Employment Training scheme. Accordingly from the 12th of September the under 18s have not been entitled to claim unemployment-related benefits. This

Table 4: Vacancy flows at Jobcentres, standardised, seasonally adjusted Scotland

Thousands of which:

Date	In-flow Level	In-flow Average change 3 months ended	Out-flow Level	Out-flow Average change 3 months ended	Placings Level	Placings Average change 3 months ended
1987 Oct	20.9	0.2	20.1	0.1	17.2	0.0
Nov	21.7	0.6	21.1	0.6	18.0	0.4
Dec	22.1	0.6	22.2	1.0	18.8	0.8
1988 Jan	20.5	-0.1	21.6	0.5	18.1	0.3
Feb	20.2	-0.5	20.6	-0.2	17.3	-0.2
Mar	20.6	-0.5	20.4	-0.6	17.1	-0.6
Apr	20.7	0.1	20.4	-0.4	17.3	-0.3
May	20.8	0.2	20.5	0.0	17.4	0.0
June	20.9	0.1	21.5	0.4	18.2	0.4
Jul	20.1	-0.2	19.8	-0.2	16.6	-0.2
Aug	20.9	0.0	20.7	0.1	17.5	0.0
Sep	21.2	0.1	20.7	-0.3	17.4	-0.3
Oct	21.0	0.3	21.0	0.4	17.6	0.3

Source : Department of Employment

mainly affected the unemployment count from October 1988.

To facilitate comparison a consistent series for unemployment, calculated on the basis of the new eligibility criteria, has been derived. Thus in September of this year, for example, total unemployment on the previous eligibility criteria, is estimated to have been 283.1 thousand. Had the new criteria been in force at the appropriate date measured unemployment would have been estimated to be 272.3 thousand, a reduction of over 10 thousand. The Government's view is that since all under 18s have the option of joining YTS, those who choose not to take advantage of it are not genuinely "unemployed". From the perspective of the economists' definition of unemployment as a state actively seeking work at prevailing wages, however, the case is perhaps less clear cut.

Both seasonally adjusted series make adjustment to the September 1988 figures in an attempt to allow for the temporary over-recording caused by the postal strike. (The outflow from unemployment was under-recorded in August due to delays in notification of leaving the register. Accordingly unemployment was over-recorded in September.)

On the new basis of calculation, seasonally adjusted unemployment has fallen in each month since January 1987. In October 1988 total unemployment fell by 1.7 thousand of which 0.5 thousand were male and 1.2 thousand female. Over the year to October 1988 total unemployment fell

Table 5 Scotland - Unemployment - seasonally adjusted (excluding school leavers (000s) (Figures in parentheses reflect estimates on September 1988 basis - see text for details)

Date		Male	Female	Total	Change since previous month	Average change over 6 months ending	Unemployment rate percentage of working population
1984		235.2	106.4	341.6			14.0
1985		243.6	109.3	353.0			14.2
1986		248.1	111.8	359.8			14.5
1986	Dec	242.6	104.8	347.4	1.2	1.1	14.0
1987	Jul	232.9	97.8	330.7	-3.2	-3.0	13.3
	Aug	229.4	96.8	326.2	-4.5	-3.3	13.1
	Sept	226.4	93.9	320.3	-5.9	-3.8	12.9
	Oct	223.2	92.3	315.5	-4.8	-5.1	12.7
		(219.8)	(89.6)	(309.4)	(-4.2)	(-4.7)	(12.5)
	Nov	220.2	91.1	311.3	-4.2	-4.3	12.5
		(216.7)	(88.4)	(305.1)	(-4.3)	(4.0)	(12.3)
	Dec	218.2	90.5	308.7	-2.6	-4.2	12.4
		(214.5)	(87.8)	(302.3)	(2.8)	(-4.1)	(12.2)
1988	Jan	216.0	90.2	306.2	-2.5	-4.1	12.3
		(212.4)	(87.3)	(299.7)	(-2.6)	(-3.9)	(12.1)
	Feb	213.5	89.9	303.4	-2.8	-2.8	12.2
		(209.7)	(86.9)	(296.6)	(-3.1)	(-3.7)	(11.9)
	Mar	211.6	88.5	300.1	-3.3	-3.4	12.1
		(207.7)	(85.6)	(293.3)	(-3.3)	(-3.4)	(11.8)
	Apr	208.8	86.5	294.9	-5.2	-3.4	11.9
		(208.6)	(83.8)	(288.4)	(-4.9)	(-3.5)	(11.6
	May	206.0	85.1	291.1	-3.8	-3.4	11.7
		(202.5)	(82.3)	(284.8)	(-3.6)	(-3.4)	(11.5
	Jun	202.5	83.4	285.9	-5.2	-3.8	11.5
		(199.0)	(80.7)	(279.7)	(-5.1)	(-3.8)	(11.3
	Jul	199.3	82.7	282.0	-3.9	-4.0	11.4
		(196.0)	(79.9)	(275.9)	(-3.8)	(-4.0)	(11.1)
	Aug(r)	197.5	82.1	279.6	-2.4	-4.0	11.3
		(194.3)	(79.1)	(273.4)	(-2.5)	(-3.9)	(11.0)
	Sept(p)	201.0	82.1	283.1	3.5	-2.8	11.4
		(194.2)	(78.1)	(272.3)	(-1.1)	(-3.5)	(11.0)
	Oct(p)	(193.7)	(76.9)	(270.6)	(-1.7)	(-3.0)	(10.0)

(p) Provisional and subject to revision.
(r) Revised.

Table 6: Unemployment flows - standardised, unadjusted: Scotland (000s)

Month ending		In-flow	Out-flow
1987	Oct	46.7	54.5
	Nov	44.0	47.5
	Dec	38.2	35.3
1988	Jan	43.0	34.6
	Feb	39.8	48.2
	Mar	35.6	46.1
	Apr	38.3	44.6
	May	32.5	45.8
	Jun	35.5	44.2
	Jul	43.0	41.5
	Aug	34.2	40.1
	Sep*	43.4	43.3
	Oct	37.9	55.2

* The September figures are biased by the postal strike.

by nearly 39 thousand of which roughly 26 thousand were male and 13 thousand female. This is reflected in a fall in the aggregate unemployment rate from 12.5% to 10.99%.

To facilitate comparison with the latest employment data it is instructive to consider changes in unemployment over the year to June 1988 for which purpose the "old" series seems most appropriate). Total unemployment fell by 48 thousand of which 33 thousand were male and 15 thousand female. We have seen, however, that over the same period the number of male employees actually fell by around 10 thousand and the number of female employees rose by 12 thousand. It seems clear that the net reduction in male unemployment does not reflect a movement into a job as an employee within Scotland, and unlikely, given the figures presented earlier, that it reflects an increase in self-employment in Scotland. Migration may represent part of the answer but data do not currently permit discrimination among alternative hypotheses.

Table 6 presents the flows into and out of the unemployment stock over the past year. The estimated inflow in Octoher 1988 was 8.8 thousand less than in the same month of the previous year and the outflow was 0.7 thousand greater. In both cases, of course, (since unemployment has been falling), outflows exceed inflows, and unemployment fell by more in October 1988 than in October 1987. The flows are quite large relative to the outstanding stock. Thus if October 88's outflow rate of 55.2 thousand per month were to he maintained the entire unemployment stock of 270.6 thousand would turnover completely in a little under 5 months. However, such an 'average duration' rate makes little sense given the heterogeneity amongst numbers of the unemployment stock.

Tables 7 and 8 give some flavour of the range of unemployment durations experienced in Scotland in July 1988 and July 1987. The reduction in the proportion of unemployed who have been so far over 12 months declined over the period from 41.5% to 40.3%. Thus the fall in unemployment has had a slightly greater than proportionate impact on the long-term unemployed. As might be expected the reductions in long-term unemployment were greatest amongst the younger age-groups, but all groups exhibited improvements in absolute terms.

C. PARTICIPATION: STOCKS AND FLOWS

1985 based projections of the Scottish population and labour force to 1995 suggest a slight increase in the total lahour force over the period of 12,000. (Source: Labour Market Quarterly Report, August 1988). However, a fairly dramatic change in the age composition of the labour force is projected as table 9 demonstrates. The low birth rate in the 1970s (taken together with views on fertility, morality and migration) is projected to result in a 31.5% reduction in the number of 16-19 year olds over the period 1985-95. The 16-24 year old population is also likely to fall (by 26.1%) largely because of this demographic influence and partly because of an increased tendency to stay longer at school.

The scale of the change will almost certainly necessitate significant labour market adjustments, perhaps most immediately in terms of employers hiring practices. In the context of moderately competitive labour markets some upward adjustment

Table 7: Unemployment Age & Duration: April 14 1988

Duration of Unemployment in Weeks	Male <25	25-54	55+	All ages	Female <25	25-54	55+	All ages
2 or less	4,681	4,728	654	10,063	3,503	4,350	264	8,117
Over 2-4	5,093	4,338	506	9,937	4,024	2,743	115	6,882
4 - 8	6,882	6,900	831	14,553	4,022	3,593	220	7,835
8 - 13	5,504	6,510	889	12,903	2,810	3,266	246	6,322
13 - 26	11,143	14,505	2,209	27,857	6,184	7,665	570	14,419
26 - 52	14,310	18,142	3,174	35,626	8,333	9,586	886	18,805
52 - 104	9,109	17,284	2,937	29,330	4,429	5,424	987	10,840
104 - 156	3,240	10,190	2,112	15,542	1,670	2,695	743	5,108
156 - 208	1,836	7,681	1,862	11,379	833	1,732	621	3,186
208 - 260	890	5,836	1,745	8,471	423	1,179	570	2,172
> 260	1,345	19,947	4,877	26,169	622	2,858	1,496	4,976
	63,973	116,061	21,796	201,830	36,853	45,091	6,718	88,662

Table 8: Long-term Unemployment: Scotland July 1988, July 1987

Age	Long-term Unemployed	Total	%Long-term Unemployed
July 1988			
Less than 20	7,622	39,911	19.1
20-34	44,254	133,231	33.2
35-54	47,347	88,836	53.3
55 and over	17,960	28,492	63.0
TOTAL	117,183	290,492	40.3
July 1987			
Less than 20	11,535	51,181	22.5
20-34	57,563	158,121	36.4
35-54	53,724	101,183	53.1
55 and over	19,390	32,360	59.9
TOTAL	142,212	342,845	41.5

Source: Department of Employment

Table 9: 16-19 and 16-24 year old population 1985 based projections to 1995

Year	16 - 19 year old population	16 - 24 year old population
1985	349,149	796,463
1986	343,080	790,577
1987	336,469	782,243
1988	325,627	767,139
1989	311,230	741,913
1990	294,804	716,796
1991	277,136	692,537
1992	263,364	667,165
1993	249,551	636,919
1994	241,244	609,066
1995	239,021	588,674

Source: Labour Market Quarterly Report: TA Office for Scotland in the 'net advantages' offered to young recruits is likely to occur as employers bid for an increasingly scarce resource. However, the required extent of adjustment will be moderated through substitution of older and perhaps female adult workers (whose 'activity rate' is projected to increase further). Even if 'price' adjustments fail to occur, rationing effects are likely to enforce some degree of substitutability eg through providing greater incentives to the retraining of older workers.

Industrial Relations in Scotland

Issues of reform and change continue to dominate Scottish industrial relations. The current attempted takeover of Scottish and Newcastle, and plans to close the Royal Ordnance Factory at Bishopton have raised, once again, fears as to job losses and the implication of an increasing proportion of the Scottish economy being controlled from elsewhere.

Similar issues of change and increasing outside control, or Anglicisation, underline the current questions confronting Scottish education. Almost two years ago the Quarterly Economic Commentary had noted that "despite the distinctive history, structure and identity of the Scottish education system it is being subject to the same package of reforms as that in England and Wales, both systems are facing the prospect of being forcibly re-moulded into a single 'national' education structure". It is pertinent, therefore, to examine current developments in England and Wales as constituting the likely employment problems north of the Border.

The EIS campaign against such moves was in process before the Government's intentions were confirmed in the Queen's speech. The first provision, enabling schools to opt out from local authority control, was well known. At present, however, it is envisaged that such school boards will not have the same powers, with respect to the hiring and firing of teachers, as enjoyed by school boards in England and Wales. Potentially, there are a number of employment implications for the introduction of school boards. First, it will be necessary to devise some mechanism by which the boards can express their views on teachers with respect to the process of rewarding "good teachers", a legacy from the previous settlement. Secondly, the process for promotions and transfers of teachers are unclear. Thirdly there could be implications for teacher development in opted out schools. It is unclear as to whether the staff from opted out schools would be able to use centrally provided facilities for training and development. This issue would be more contentious if opted out schools developed the practice of parental topping up of school income. Fourthly, there are the issues of provision of flexibility of cover and replacements, all important in the current climate of declining school rolls. Finally, the creation of school boards will affect the moves towards managerialism in schools and pose questions for the powers and authorities of schodl heads. This will be a critical feature for the well-being and motivation of tbe whole school.

The provisions for devolving power to local college councils link clearly to the abolition of the joint negotiating body for teaching staff in further and grant aided higher education. It is likely that variations in pay rates between colleges and regions will appear. Within colleges increased tensions are likely as to whether those involved in income creation should he rewarded more highly than those engaged in essential, but non-income raising activities.

The introduction of technology academies will pose all of these employment issues, and will raise the question of the scale of differences in salary structures. The city technologies, or technology academies, are to have longer hours and different conditions of work. Moreover, if such academies are well supported by parents, teachers' workloads may he greater. As such there may well be pressure for recognition of such differences in salary grades. This would imply the move towards a version of school level negotiation and personnel management.

Mr Rifkind's decision in principle, to proceed with the abolition of section 88 of tbe 1980 Education (Scotland) Act is prompted to make it less impossible to dismiss incompetent teachers. An essential prerequisite will be a definition of duties, agreed methods of assessment of performance (and by implication appraisal), and the introduction of warning procedures. Issues of transfer, promotion, work loads, as well as dismissal, will provide considerable scope for argument at tribunals.

Change, in the form of competitive tendering constitutes the second major issue in Scottish industrial relations. Within the Health Service the impact of competitive tendering has been felt both in job losses and changes to employment conditions. There are similar implications for local authorities and their staff. Already a number of councils are briefing staff as to the implications and requirements of the Local Government Act. Again experience in England proves a useful indication of possible and likely future developments in Scotland. Bradford with its proposals to sell off council assets, and alter terms and conditions of staff is more than an extreme view of the future. Already a number of Scottish authorities have sought to employ senior staff on non-standard conditions as well as planning for future changes in terms and conditions for clerical and manual staff and for a devolved organisation of the personnel function.

Elsewhere an inter-union dispute has emerged with the formation of a breakaway Television and Film Production Association. This was formed as a reaction to ACTT plans to amalgamate with Broadcasting and Entertainment Trades Alliance.

The likely effects of 1992 are beginning to prompt concern as to employment relations. MSF has suggested the establishment of joint committees, language training, cross border joint consultation committees with multi-national companies. Visions of massive increases in labour flexibility are largely unwarranted, but impact will be considerable in several ways. Increased product competition will imply considerable costs in retraining and flexibility to be competitive. An influx of foreign labour in certain projects, especially short-term contract or project labour in building and construction and a further growth in limited areas of the service sector.

Questions of regrading of nursing staff provided the greatest comment. The implementation of the agreed scheme has led to a significant number of issues mostly over the appropriate and fair grade for nursing sisters. By end of November several health Boards, and especially the GGHB, had accepted a number of appeals and made concessions as to grading. The fundamental questions are the nature of supervision of wards. The key would appear to be the division between grades F and G. Grade F covers staff nurses/midwives, deputy sisters and sisters who have continuing responsibility for managing a ward with no teaching and limited nursing/midwifery intervention required, or have enhanced qualifications and experience, teach students, but are not responsible for managing wards. Grade G is defined as sisters/midwives and senior nurses continuously responsible for assessment and care and management of a ward, including deployment and supervision of staff and where the teaching of students and or extensive nursing/midwifery intervention is required. It is clear that wards require 24 hour supervision, yet the grading scheme has been interpreted to imply only one G graded sister per ward. A further issue is whether the regrading should be task or finance led, staff suspicions that it has been the latter have contributed to a worsening of morale and an increased preparedness to undertake some form of protest. There is much to support a general rather than an appeal-based resolution to this issue if low morale is thought to be a key issue.

Regional Review

REGIONAL LABOUR MARKETS

The previous Labour Market section primarily looked at the movements of the Scottish labour market. Whilst it is true that Scotland has a labour market distinct from the rest of the UK, employment characteristics within this nation are not homogeneous. It is the purpose of this section to highlight the variations in trends in unemployment and vacancies which occur both across Scotland and within the local authority regions. The data employed to these ends differ somewhat from those used in the Labour Market section. Typically, the figures used in the latter are adjusted for seasonal factors, while those used below are unadjusted. Moreover, the denominator used to calculate unemployment rates at the sub-Scottish level is defined more narrowly than the Scottish one (which includes estimates of the self-employed and H M Forces). As a result, the reported sub-Scottish unemployment rates are greater than the Scottish rate, and not wholly consistent with it.

The recent extension of the guaranteed offer of a YTS place to all those aged under 18 who have not found a job, and the consequent change from the 12th of September in the entitlement of young people to claim unemployment - related benefits, have inevitably affected the claimant count in unemployment statistics. The result of this is that October 1988 data are not strictly comparable with October 1987 figures and thus when interpreting Tables 1 and 2, caution should be exercised.

Table 1 shows that unadjusted unemployment in Scotland has fallen by over 60,000 between October 1987 and October 1988, a decline of 18.5%. Unemployment, as a percentage of the working population, now stands at 10.7%, which compares favourably with 13.1% twelve months ago. Although unemployment has declined in all regions, the rate of decline has not been uniform. The Borders experienced the largest reduction, with 24.6% fewer people unemployed in October 1988 than at the same time in 1987. Elsewhere, Central, Grampian and Lothian regions have all witnessed falls in excess of 21%, while an above average decrease was recorded in Tayside. These changes leave the Borders as the region with the lowest unemployment rate at 6.3%. The low rates in the Shetland Islands and Grampian region, 6.5% and 6.7% respectively, can be regarded as indicative of the importance of the oil industry revival to these localised economies. Despite a fall of 30,761 in the number of unemployed in Strathclyde, a below average decline of 17.4%, it still remains the mainland region with the highest unemployment rate at 14.4%, which does not compare well with the 10.7% Scottish average. The Western Isles, with a well-below average decline in unemployment of 1.4%, is the region with the highest unemployment rate, currently standing at 20.9%.

Table 1: Unemployment by region

	% rate Oct 88	Total Oct 88	Total Oct 87	Total Change	% change in Total
Borders	6.3	2,404	3,189	-785	-24.6
Central	11.9	12,491	16,526	-4,035	-24.4
Dumfries & Galloway	10.7	6,066	6,852	-786	-11.5
Fife	12.3	16,545	20,245	-3,700	-18.3
Grampian	6.7	15,374	19,715	-4,341	-22.0
Highland	11.6	10,268	12,097	-1,829	-15.1
Lothian	9.4	34,158	43,414	-9,256	-21.3
Strathclyde	14.4	146,133	176,894	-30,761	-17.4
Tayside	11.0	18,416	22,884	-4,468	-19.5
Orkney Is.	10.4	701	821	-120	-14.6
Shetland Is.	6.5	638	743	-105	-14.1
Western Is.	20.9	2,052	2,082	-30	-1.4
Scotland	10.7	265,246	325,462	-60,216	-18.5

Source: Department of Employment

Against a background of generally declining unemployment, the female total has fallen more quickly than the male total. Between October 1987 and October 1988, female unadjusted unemployment fell by 21,758, a decline of 22.4%, to stand at 75,483. During the same period, male unemployment fell by 16.9% to 189,763. Of the

Table 2: Unemployment by Sex and Region

	No Unemployed October 1988		No Unemployed October 1987		% change since October 1987	
	Males	Females	Males	Females	Males	Females
Borders	1,601	803	2,052	1,137	-22.0	-29.4
Central	8,413	4,078	11,251	5,275	-25.2	-22.7
Dumfries & Galloway	3,897	2,169	4,394	2,458	-11.3	-11.8
Fife	11,311	5,234	13,588	6,657	-16.8	-21.4
Grampian	10,119	5,255	12,819	6,896	-21.1	-23.8
Highland	7,144	3,124	8,425	3,672	-15.2	-14.9
Lothian	24,440	9,718	30,406	13,008	-19.6	-25.3
Strathclyde	107,610	38,523	127,302	49,592	-15.5	-22.3
Tayside	12,787	5,629	15,438	7,446	-17.2	-24.4
Orkney Islands	466	235	559	262	-16.6	-10.3
Shetland Islands	80	258	448	295	-15.2	-12.5
Western Isles	1,595	457	1,539	543	+3.6	-15.8
Scotland	189,763	75,483	228,221	97,241	-16.9	-22.4

Source: Department of Employment

twelve local authority regions located in Scotland, eight saw a greater decline in female unemployment than in male unemployment. The Borders witnessed the greatest decline in female unemployment, a fall of some 29.4% in the twelve months heing considered. At the other end of the scale, female unemployment only fell by 10.3% in the Orkney Islands. In Central and Highland regions and Orkney and Shetland Islands, the decline in male unemployment outstripped the decline in that for females. With the exception of the Western Isles, male unemployment fell in all regions ranging from 25.2% in Central region to a decline of 11.3% in Dumfries and Galloway. Male unemployment in the Western Isles rose by 3.6% in the twelve months from October 1987. This does, however, represent a slight improvement over last quarter's figures in which the rise was 7.2%.

Table 3 indicates the levels of vacancies in the regions and relates these to the levels of unemployment. The vacancy figures represent only those unfilled vacancies notified at Job Centres and Careers Offices on the reporting date, which in this case was the 7th of October. Such vacancies represent approximately one third of the total at any given date and are typically for lower paid and lower skilled jobs. Consequently, it would be erroneous to consider the published vacancy data as providing a complete picture of current demand for labour. However, as a consistent series the vacancy figures provide a useful guide to regional variations and developments.

Vacancies at Job Centres are mainly for adults aged 18 or over, but include some vacancies for persons under 18. Vacancies at Careers offices are mainly for young persons under 18 years of age, but include some vacancies suitable for adults. Occasionally, a vacancy will be notified to both services or to more than one Job Centre by an employer, and thus will be included in more than one vacancy count. This introduces an element of double-counting into the analysis but it is hoped that at a regional level, the effects will be negligible.

Previously, two types of vacancy were

Table 3: Registered Vacancies* and Unemployment/ Vacancy Ratios by Region, October 1988

	Total Vacancies	U/V Ratio
Borders	480	5.0
Central	1,286	9.7
Dumfries & Galloway	687	8.8
Fife	1,265	13.1
Grampian	3,294	4.7
Highland	770	13.3
Lothian	3,061	11.2
Strathclyde	9,865	14.8
Tayside	1,512	12.2
Orkney Islands	57	12.3
Shetland Islands	75	8.5
Western Isles	69	29.7
Scotland	2,421	11.8

* Unfilled Vacancies at Job Centres and Careers Offices

Source: Department of Employment

distinguished: those for "actual" jobs and those for Community Programmes. However, with the introduction of Employment Training (ET) in September 1988, there are no longer any CP vacancies. ET places are training opportunities determined according to the individual needs of unemployed people and therefore cannot be considered nor counted as vacancies. As a result of these changes, vacancy data and unemployment/vacancy ratios presented in this Commentary are not compatible with the corresponding data in previous issues of the Commentary.

The unemployment/vacancy (U/V) ratio can be interpreted as a broad indication of the number of registered unemployed people competing for each vacancy. However, since registered vacancies account for only a proportion of the total, the true U/V ratio is likely to he lower. On the other hand, not only registered unemployed people will compete for vacancies and this will have the opposite effect on the ratio.

The U/V ratio for Scotland stands at 11.8. Strathclyde is the mainland region exhibiting the highest ratio,, currently 14.8. Other mainland regions with ratios above the Scottish norm are Fife, Highland and Tayside. The U/V ratio for the Western Isles, at 29.7, is exceptionally high and reflects the high unemployment rate of 20.9% in this area. The low unemployment regions of Grampian and the Borders have comparatively low ratios of 4.7 and 5.0 respectively and these may he indicative of current or near future recruitment difficulties. Below-average ratios were also recorded in Dumfries and Galloway, and Central and Lothian regions.

Variations in labour market conditions occur within regions as well as among them. The issues of intra-regional variations in unemployment are addressed in Tables 4 and 5 which focus on Travel-to-Work-Areas (TTWAs). A TTWA is an approximation to a self-contained labour market, that is, an area within which most commuting to and from work occurs within the boundary of that area. It is the smallest area for which unemployment rates are calculated. If the majority of TTWAs contained in a region have rates in excess of the regional figure this indicates

Table 4: TTWAs with unemployment rates above the Scottish and Regional Average

	No of TTWAs	No above Scottish Average*	No above Regional Average*
Borders	5	0 (0)	2 (2)
Central	3	2 (2)	1 (1)
Dumfries and Galloway	7	3 (3)	3 (3)
Fife	3	2 (2)	1 (1)
Grampian	9	1 (1)	8 (8)
Highland	8	6 (5)	5 (5)
Lothian	3	1 (1)	1 (1)
Strathclyde	12	11 (10)	7 (5)
Tayside	7	2 (2)	2 (2)
TOTAL	57	28 (26)	30 (28)

* Figures in brackets refer to the previous quarter.

Source: Department of Employment

the presence of a few areas, possibly even one, with significantly below-average unemployment. Conversely, a low proportion of TTWAs with above average unemployment implies the existence of a high unemployment area. As the last column of Table 4 indicates, Grampian region is an example of the former case. Eight out of the nine TTWAs located within Grampian region, have unemployment rates above the regional average. The regional average is drawn down by the large, low-rate TTWA of Aberdeen where the unemployment rate is 5.4%.

Table 5: TTWAs with highest and lowest unemployment rates

		%	High-Low	High-Low
Borders	H Berwickshire	9.4	4.3	1.84
	L Galashiels	5.1		
Central	H Alloa	16.3	6.5	1.66
	L Stirling	9.8		
Dumfries	H Cumnock & Sanquhar	24.2	16.2	3.03
& G/way	L Dumfries	8.0		
Fife	H Kirkcaldy	13.8	5.3	1.62
	L North East Fife	8.5		
Grampian	H Forres	20.4	15.0	3.78
	L Aberdeen	5.4		
Highland	H Sutherland	16.0	6.4	1.67
	L Inverness/Thurso	9.6		
Lothian	H Bathgate	12.5	5.1	1.69
	L Haddington	7.4		
S/clyde	H Girvan	19.6	10.5	2.15
	L Oban	9.1		
Tayside	H Arbroath	15.6	7.5	1.93
	L Forfar	8.1		

Source: Department of Employment

An indication of the distribution of unemployment within regions may also be obtained from Table 5. It indicates for each region, the TTWA with the highest and lowest unemployment rate. While Dumfries and Galloway's TTWAs exhibit the biggest range in unemployment rates, ranging from 24.2% in Cumnock and Sanquhar, to 8% in Dumfries, the ratio of highest to lowest is of the largest magnitude in Grampian region, where unemployment in Forres is 3.78 times greater that that in Aberdeen. The ratio is also greater than 2 in Dumfries and Galloway, and Strathclyde. In contrast, six mainland regions have a ratio of highest to lowest unemployment rates less than 2 with Fife's 1.62 the lowest overall. A low ratio is indicative of a relatively even distribution of unemployment within a region whilst a high ratio suggests a wide disparity.