Quarterly Economic Commentary

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Notes to contributors

The editors welcome contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Scottish Editor.

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QUARTERLY ECONOMIC COMMENTARY

***** COMMENTARY *****

***** VIEWS *****

Outlook and Appraisal

Recent developments again highlight the significance of external economic forces to the well-being of the Scottish economy. Yet, as events unfold, with major redundancy decisions, inward investment announcements, and other economic news, it is tempting to forget that such events occur within a broader economic context.

The Scottish economic news during the period since the publication of the November **Commentary** has, to say the least, been mixed.

At the macro-economic level, seasonally adjusted unemployment rose in successive months while in the UK the same statistic fell (see **Labour Market** section). The harmful effects of the oil price fall on an oil supply industry largely localised in Scotland accounts, in part, for this widening disparity in unemployment between Scotland and the rest of the UK. On the other hand, the fall in the price of oil, the related depreciation of sterling, the earlier reduction in inflationary expectations and marginal improvements in world economic growth, have led to improvements in output and employment growth in the UK (see **World Economy** and **British Economy** sections). These potential benefits to the non-oil sector are now beginning to be felt in Scotland. Both the **Scottish Business Survey** and the **CBI Survey** report a significant improvement in business optimism. Optimism is high in retail distribution due to the UK-wide boom in consumer spending and retail sales. The construction industry, where conditions have been much depressed, now has a small positive balance of respondents with more favourable expectations as increased public sector orders are anticipated. The 8% projected increase in the UK Government's capital spending, in constant price terms, announced in the Chancellor's Autumn Statement, must in part account for this expectation. In manufacturing, a positive 14% of respondents expect an improvement in their general business situation, an exact reversal of the position reported in the last **Commentary** (see **Business Surveys** section). While sudden movements in expectations should be interpreted with care, it is clear that much of the growth in demand underlying the more favourable climate derives from an improvement in export orders and sales to the rest of the UK. An outcome which is consistent with the view that improvements in UK economic performance eventually spread, after a lag, to Scotland and other peripheral regions of the UK.

However, against the news of general improvements in the expected demand for Scottish products must be set the large number of redundancies and closures announced over the last three months by major companies operating in Scotland. Since the middle of November there have been at least 12 major redundancy or closure announcements involving one hundred workers or more. From these announcements alone, over 6,000 workers will lose their jobs, and most by the end of the year. In contrast, during the same period, 5 major announcements of openings and expansions were recorded, offering permanent employment for over 1,300 workers by the end of the decade, a not insignificant achievement by recent standards. Clearly, it is unwise to generalise from such partial data. At least two of the redundancy and closure announcements, Scott-Lithgow and Kestrel Marine, involving 2,000 jobs, can be directly attributed to the effects of the oil price fall. Of the others, it could be said that one, Caterpillar, is the product of peculiar and possibly unique circumstances, while the remaining 2,300 job losses could be viewed as the outcome of economic adjustments which are inevitable in any dynamic economy. We believe that it would be a mistake to adopt such a sanguine view. On the contrary, there are strong grounds for believing that the recent set of openings, redundancies and closures are more properly viewed as symptoms of longer-term trends in industrial restructuring, rather than random fluctuations or short-term adjustments with little long-run significance. And these trends, if they continue, are unlikely to favour the Scottish economy.

Following the recent publication of the 1984 Census of Employment, which is the subject of the **Briefing Paper** by Boyle and Jenkins, much media attention has been given to the so-called north-south divide. Members of the government, like Nelson, largely turned a blind eye, or responded with mocking disbelief. Yet the issue of the increasing regional imbalance in economic activity within the UK cannot be so easily dismissed. To believe that references to "areas of prosperity in the north", or "success in attracting inward investment", are an adequate response to the accumulating evidence, is tantamount to the belief that a man in need of open-heart surgery will feel reassured when complimented on his ruddy complexion, or his fine head of hair. In the November **Commentary**, we highlighted the implications of growing regional disparities and other structural imbalances for short-run economic performance in the UK. Current conditions in the British economy continue to suggest the need for increased spending on regional policy both on national economic and regional equity grounds. But it is in the prospects for regional disparities in the longer run that the case for regional policy can be most clearly seen, and the recent spate of redundancies and evidence from the Census of Employment only serve to reinforce the point.

First, despite employment growth in some sectors such as electronics, instrument engineering, parts of food, drink and tobacco and in pharmaceuticals, over the same twenty-year period there has been a persistent decline in the provision of manufacturing jobs, although not in manufacturing output. The job losses are heavily concentrated in Scotland and the norht of Britain because as manufacturing industry grew it largely favoured northern locations. On the other hand, service sector industries are experiencing a sustained expansion in employment which is disproportionately concentrated in the south. It is true that there has been substantial growth of service sector employment in the north but a consideration of the evidence shows that the key intermediate producer services - financial, legal, insurance, professional, technical, distribution and maintenance activities - and intermediate consumer services - production of TV programmes, computer software, cable communications and servicing of domestic equipment - are again more likely to be found in the south. The increase in services in the north appears to be more concentrated in consumer and, in particular, in personal consumer services. And all the indications are that this process will continue.

Recent research by two Cambridge economists, Rhodes and Tyler, predicts that between 1985 and 1995 manufacturing in the UK will shed a further 800,000 jobs, which will be more than offset by a gain in service sector employment of 1.7m jobs. However, from the projected net gain of 900,000 jobs over the period, almost half are forecast to be located in the south east of England..

Several factors account for this apparent trend. The position of London as the key UK financial centre naturally means that the growing financial and business service sectors will favour south east locations. The progressive decline in regional policy expenditures and relaxation of Industrial Development Certificate control since the late 1970s, followed by the radical cutback in outlays since 1984, mean that we are now in a different policy world from the 1960s when, in admittedly different national economic circumstances, over 250,000 jobs were attracted to assisted areas largely in the north. The rundown, since the mid 1970s, of New Town and overspill policies and the growth of inner-city and urban initiatives has also served to diminish the relative attractiveness of northern locations. Furthermore, the existing and planned concentration of major infrastructure investments in London and the south east: London's third airport at Stansted; the construction of the M25 and future completion of the M11 motorways; the regeneration of London's dockland; and the construction of the Channel Tunnel, all serve to increase the relative attractiveness of the southeast of England to new jobs in manufacturing and service industry.

The process of industrial restructuring in favour of the south of Britain is, moreover, not simply the locational consequence of the growth of new industries and the decline of the old in a more permissive policy environment.

Over time changes have occurred which increase the possibility of spatial specialisation within sectors and companies. The growth in the size of companies, often operating on a world scale, and technical developments in both communications and production processes, have increased the potential for functional specialisation within companies. That, in turn, has led to spatial divisions in the location of functions. At its simplest this means that key control - or headquarter's - functions, such as investment planning, and key operating functions, such as Marketing and R & D, could be located in one location, while firms' production facilities were located elsewhere. As a result different types of employment would be offered: more highly skilled labour being required to satisfy the needs of the key control and operating functions, while less qualified labour was needed at the point of production.

Elementary economics tells us that when specialisation is possible it will occur in the market because specialisation enables the realisation of comparative advantages and internal and external economies of scale. It is clear that spatial specialisation by function has been occurring, and that it intensified in the 1970s and early 1980s, largely through a process of acquisitions and rationalisations. Inevitably this process has worked to the advantage of the south. Headquarters and key operating functions are more likely to be found in the south, while the quality of labour available in the north has probably suffered, following the outmigration of workers as the demand for key skills diminished. This process has also been overlaid on a pattern of sectoral specialisation which as we have seen has been changing, again to the probable long-run disadvantage of the north.

Overall, then, the trends discussed above appear to have led to a relative concentration of the more modern, technologically-advanced, high value added, and research-oriented sectors in the south. Specialisation within sectors and companies has also favoured the south through the location and re-location of key control and operating functions. Moreover, when the north has attracted modern growth industries, such as electronics, it has largely been through the siting of production facilities without the key control and operating functions which are so necessary to regional development.

When viewed against this background, government exhortations for wage cuts in areas of high unemployment appear, at the very least, to be a less than satisfactory approach to Britain's regional problems. The evidence suggests that the so-called north-south divide is no temporary phenomenon but seems likely to become one of the major challenges facing government, industry and the people of this country in the remaining years of the century.

18 February 1987