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Articles accepted for publication should be supplied electronically and conform to the guidelines available from Isobel Sheppard fraser@strath.ac.uk

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Fraser of Allander Institute
Department of Economics
University of Strathclyde
Sir William Duncan Building
130 Rottenrow
Glasgow G4 0GE

t: +44 (0) 141 548 3958
f: +44 (0) 141 548 5776
e: fraser@strath.ac.uk
w: <http://www.strath.ac.uk/fraser/>

Outlook and appraisal

Overview

As the Scottish economy emerges from recession a slowly strengthening recovery is threatened by the massive fiscal consolidation package introduced by the new Conservative/Liberal Democrat coalition government in the emergency Budget of 22nd June. We estimate that Scottish GDP growth will be 0.1% lower this year, 0.2% lower in 2011 and 0.1% lower in 2012 as a result of the additional fiscal tightening in the emergency Budget compared to the plans of the previous Labour government.

Our central forecast is for GDP growth of 0.7% this year, 1.1% in 2011 and 2.1% in 2012. That should be compared with our February forecast of 0.6% this year, 1.6% in 2011 and 2.2% in 2012. The changes introduced in the emergency Budget along with the postponement to 2011 of Scotland's share of the £6bn UK cuts introduced by the new government for 2010 and the fiscal tightening put in place in the March Budget of the Labour government, result in our central forecast for 2011 being 0.5% points lower than our forecast in February. This is despite the fact that wider economic forces driving recovery in 2011 are now considered to be somewhat stronger than was the case in February. On our low growth scenario, the economy teeters on the brink of recession for two years despite signs of stronger recovery worldwide.

The consequential real cuts to the Budget of the Scottish Parliament and government of around 14% may result, other things equal, in up to 126,000 economy wide job losses by 2014-15 comprising up to 90,000 in the public sector and 37,000 private sector job losses. However, if the resulting drop in demand and freeing up of resources leads to a moderation in Scottish real wages and lower purchased input and output prices then there will be a "crowding-in" effect as private sector activity, especially, benefits from improved competitiveness. In these

Figure 1: Scottish and UK quarterly GDP growth, 1998q2 to 2009q4

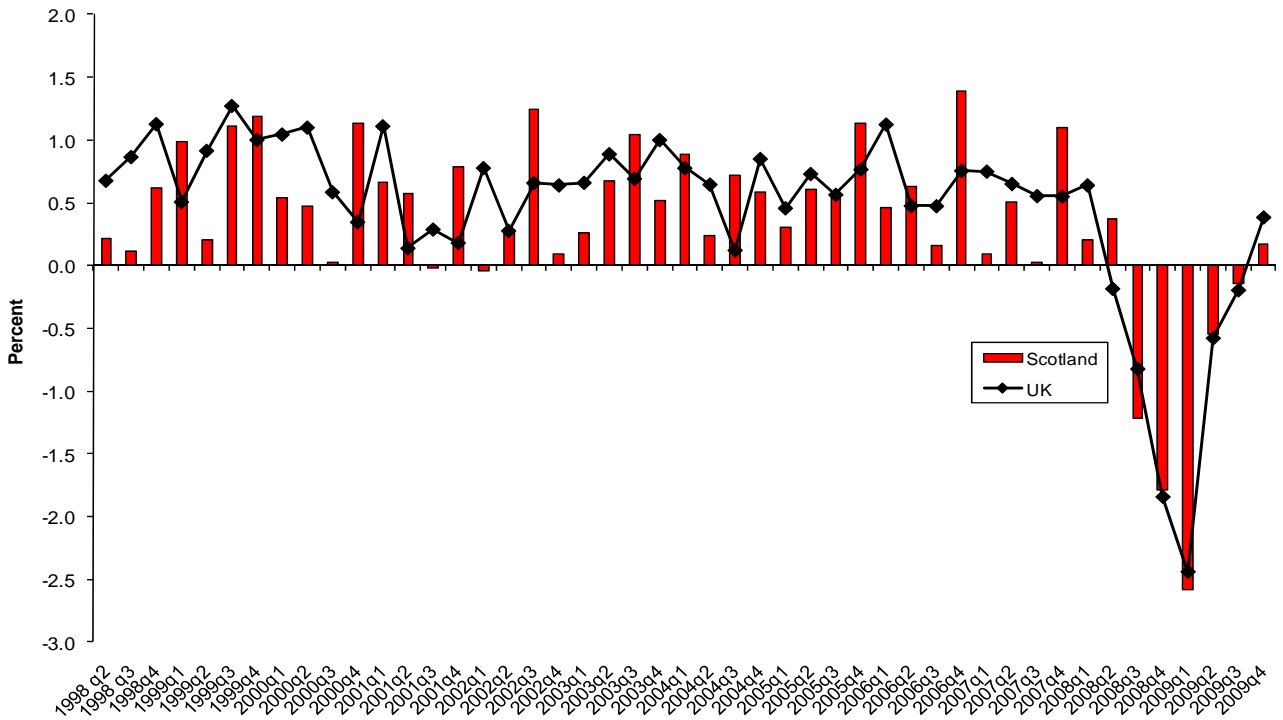


Figure 2: Scottish and UK services GVA growth at constant basic prices 1998q2 to 2009q4

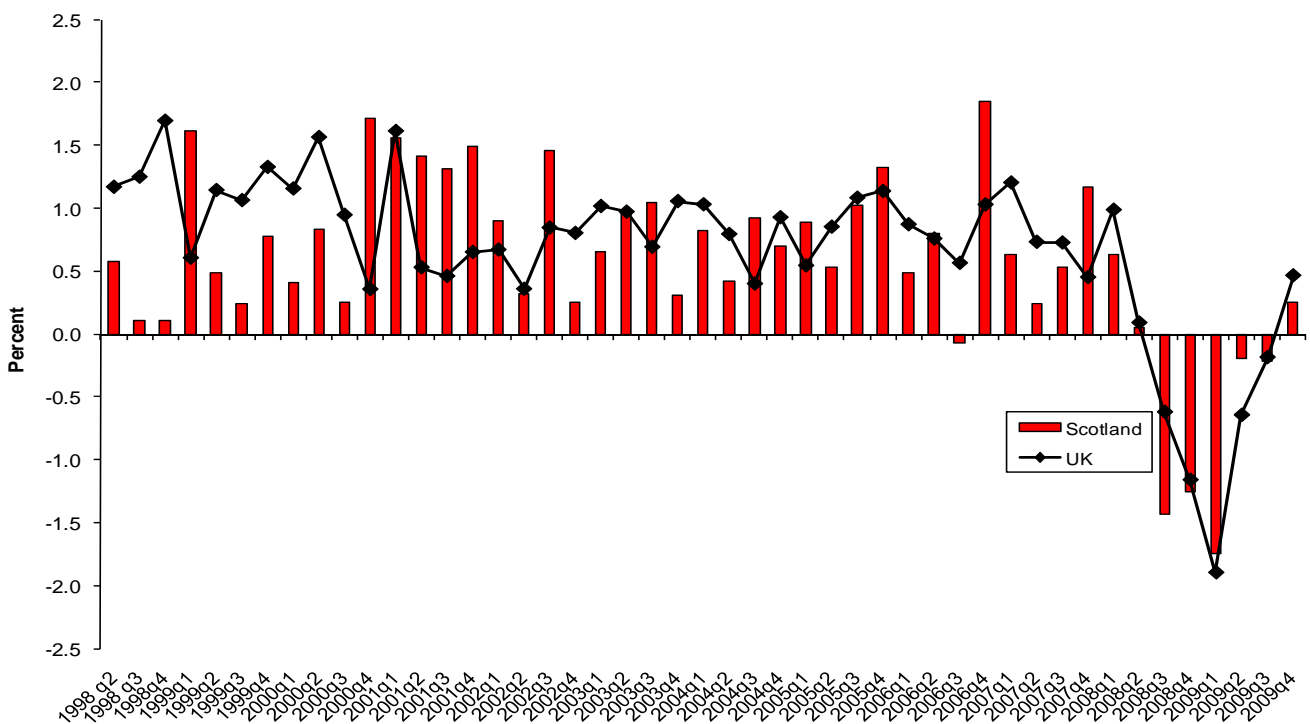


Figure 3: Scottish and UK manufacturing GVA growth at constant basic prices 1998q2 to 2009q4

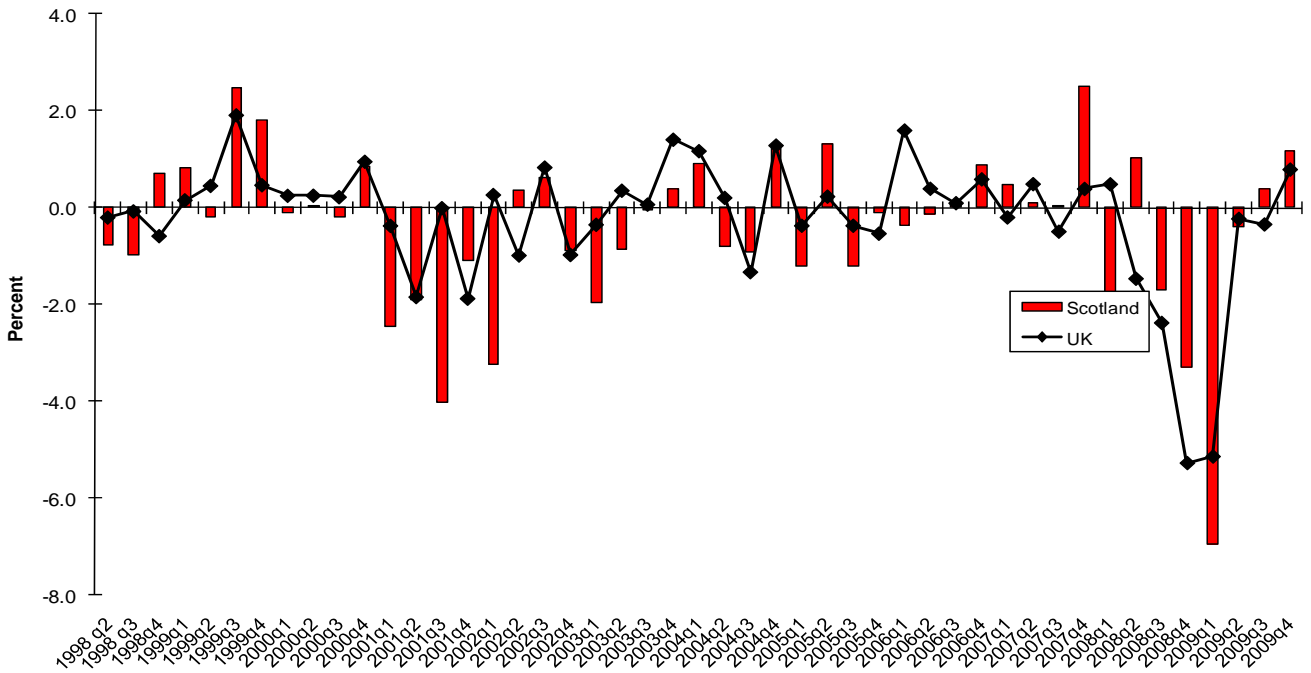
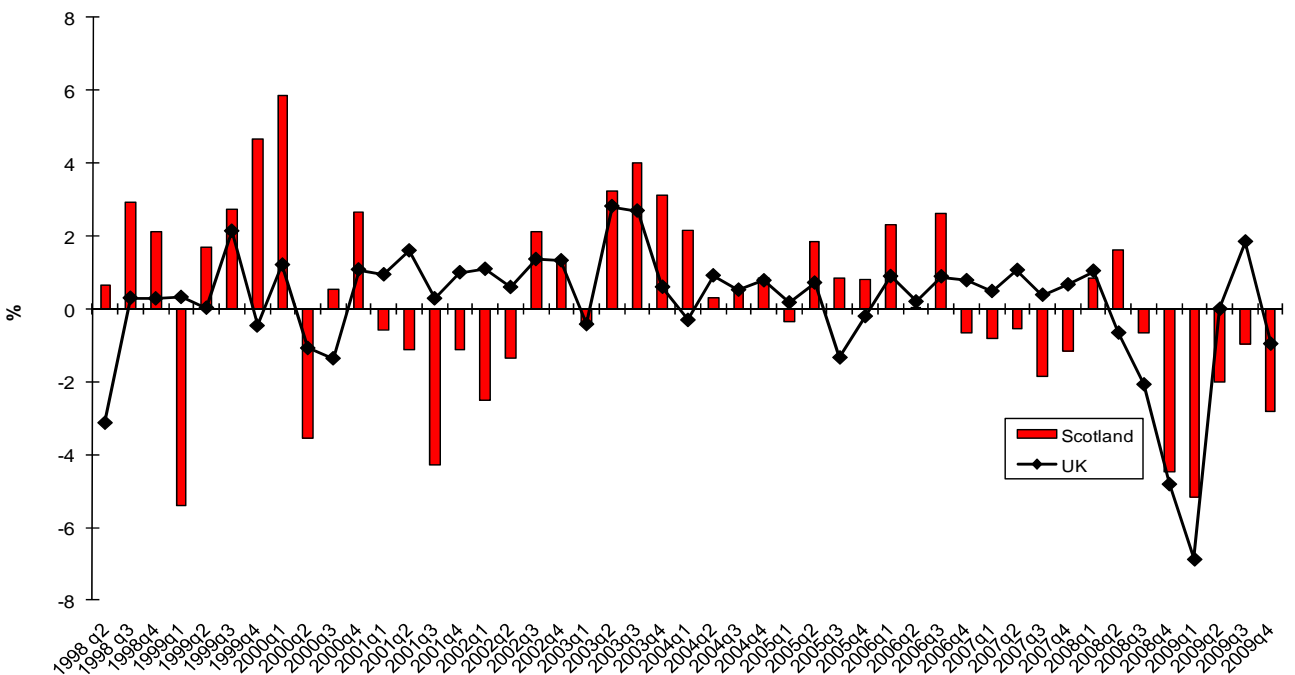


Figure 4: Scottish and UK construction GVA volume growth 1998q2 to 2009q4



circumstances of flexible wages and prices the shock will reduce jobs in the public sector by the slightly lower number of just under 78,000 while private sector employment rises by nearly 14,000. The overall job loss is thus just above 64,000, about half that in the fixed-price case. There is a "crowding in" effect on the private sector, but it is insufficient to offset the loss of activity in the public sector.

The potential cut to the Scottish Parliament and government budget is unprecedented. In such circumstances it is incumbent on the Scottish government to explore a range of options that can embrace cost savings and revenue raising as well as spending cuts. Moreover, the government will wish to identify those options that do the least damage to economic growth while preserving social justice. We hope that the Scottish Parliament and the wider public will have an opportunity to debate all of these options and build a nationwide consensus on the best way forward.

Recent GDP performance

GDP data for the Scottish economy for the fourth quarter of 2009 became available in late April. The Scottish economy finally exited the recession in the quarter growing at 0.2%, but the return to growth in Scotland was weaker than the UK at 0.4%. - see Figure 1. It is worth noting that Scotland's growth performance deteriorated relatively in the fourth quarter because in the third quarter the fall in GDP of -0.1% was a little better than the UK where the contraction was -0.2%.

In the 4th quarter 2009, the service sector – accounting for 74% of overall GVA – came out of recession with output rising by 0.2% in Scotland but by almost 0.5% in UK – see Figure 2. Over the year to the fourth quarter service sector GVA fell by -3.6%, while the recession taken as whole led to fall of -4.76% in GVA compared to fall of -4.43% in the UK.

The service sector continued to perform less well in Scotland than in the UK in the fourth quarter, but *manufacturing* (14% of GVA) again did better. In the fourth quarter Manufacturing GVA rose by 1.2% in Scotland against a rise of 0.8% in manufacturing in the UK - see Figure 3. The stronger manufacturing output performance was mirrored in the fourth quarter export figures, with Scottish manufacturing exports rising by 2.9% in real terms,

after a rise of 1% in the third quarter but a fall of -10.1% over the year to the fourth quarter.

The *construction* industry in Scotland continued to contract with GVA falling by -2.8% in the fourth quarter compared to a fall of 1% in the sector in the UK – see Figure 4.

Within services, the main sectoral drivers of recovery in the fourth quarter were *public administration, education & health* (22% of overall GVA), *hotels & catering* (3% of GVA), *real estate & business services* (REBS) (18% of GVA) *financial services* (8% of GVA), and *retail & wholesale* (11% of GVA). The public sector grew by 0.2%, hotels and catering by 1.5%, REBS by 0.7%, financial services by 0.7% and retail and wholesale by 0.1%. Financial services grew by 0.7% in Scotland compared to a fall of -0.8% in the sector in the UK – see Figure 5. This is the first time that positive growth has been recorded in the sector for 6 quarters. We must hope that this presages a sustained recovery in the sector in Scotland. Since UK financial services went into recession later than in Scotland we might expect the sector to come out of recession somewhat later than its Scottish counterpart. One service sector experienced negative growth in the fourth quarter: *transport & communication* (7% of GVA). GVA in transport & communication services was marginally negative at -0.0% in Scotland, whereas the sector grew by 0.6% in the UK.

Manufacturing in Scotland continued its recovery still outperforming UK manufacturing. The main sectors driving the recovery and the stronger Scottish performance were *electronics, other manufacturing, paper, printing & publishing, transport equipment, and drink*. *Electronics* (2.8% of GVA) grew by 6.6% in the quarter compared to growth of 2.3% in its UK counterpart. *Other manufacturing* (1.7% of GVA) grew by 3.7% whereas the sector contracted by -0.6% in the UK. *Paper, printing & publishing* (1.4% of GVA) grew by 1.5% compared to a contraction of -1% in the sector in the UK. *Transport equipment* (1% of GVA) grew by 3% but this was much less than the growth of 8.3% recorded by transport equipment in the UK, which has now been growing for three successive quarters. Finally, the *drinks* industry (1.6% of GVA) continued to grow in the quarter with growth of 2.1% while the sector in the UK expanded by 0.3%.

Other Scottish manufacturing sectors either failed to recover or remained weak. The *chemicals* industry continued to display negative growth in Scotland with output falling by -1.9% in the fourth quarter compared to growth of 0.2% in the sector in the UK. Over the year, output in the sector has fallen by nearly 20% and our hope that the significant contraction in output experienced in the 3 quarters to 2009Q3 had ceased has not been realised. *Mechanical engineering* reduced its output by -1.2% in the quarter a weaker performance than the rise of 2.5% experienced in the sector in the UK. The *metals* sector (1% of GVA)

Figure 5: Scottish and UK financial services GVA growth at constant basic prices 1998q2 to 2009q4

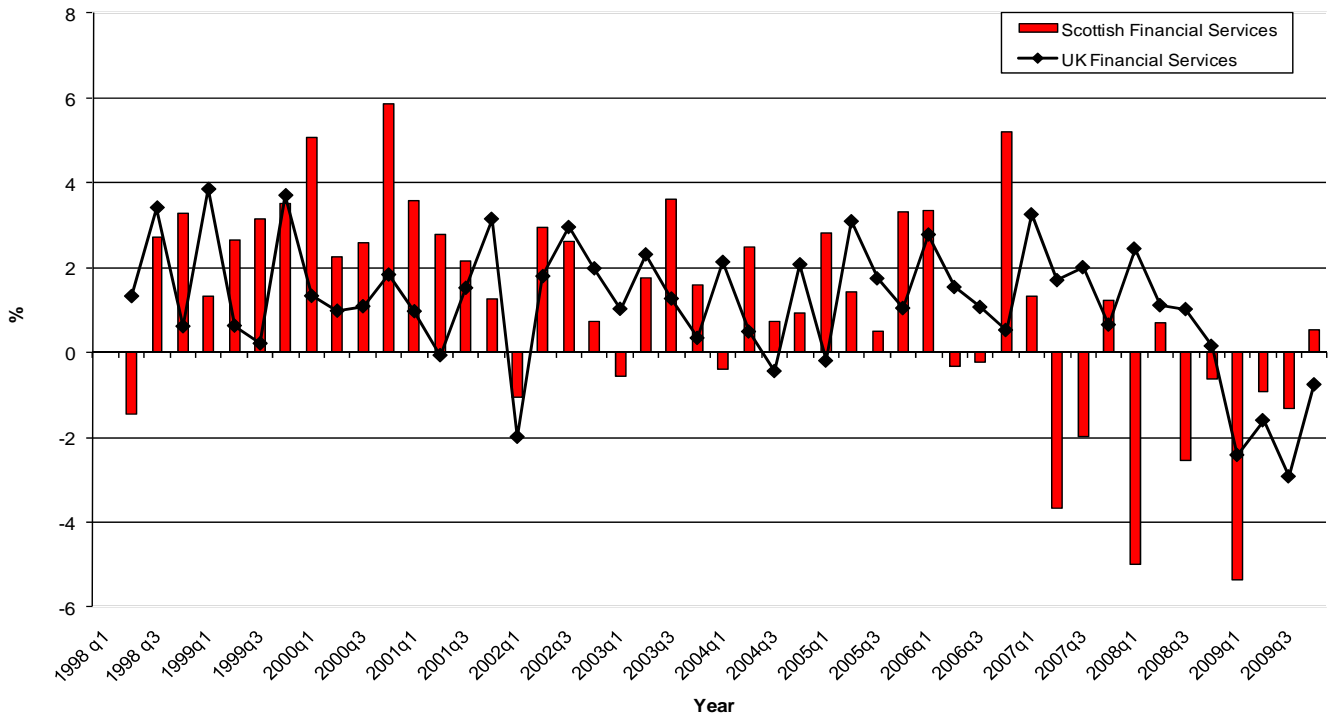
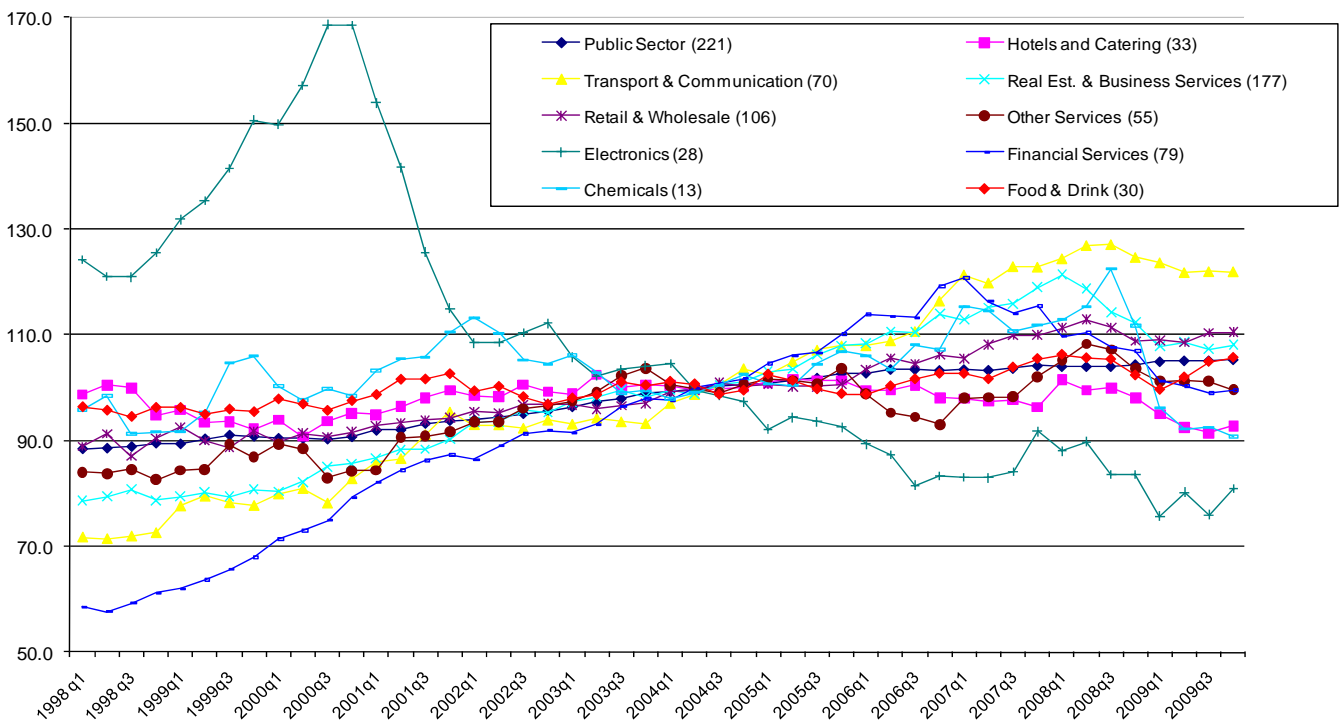


Figure 6: Growth of key sectors in Scotland 1998q2 to 2009q4



suffered a significant contraction of -8.9% compared to a rise of 0.7% in the UK. The sector has contracted by -10.4% in Scotland over the year. Finally, *Food* (1.4% of GVA) cut back production by -1% in Scotland, although this was better than the -2.4% reduction in output in the UK. Over the year the food industry in Scotland contracted by -1.7%, broadly similar to the fall in output in the sector in the UK.

Figure 6 charts the performance of key Scottish sectors over the past 12 years. The chart indicates that all key growth sectors have been affected by the recession with the exception of the public sector. But most sectors are now recovering. One other point worthy of note is that some sectors have experienced a double-dip recession: transport & communication, REBS, other services, and chemicals.

Recent survey evidence

The GVA outturn data for the fourth quarter 2009 suggest that the Scottish economy is recovering from recession but at a slower pace than the UK. On top of this, as the *Review of Business Surveys* below notes, the interpretation of recent surveys is more difficult than usual. This is due to the effects of the unduly harsh winter, especially in Scotland, the re-introduction of the 17.5% VAT rate at the start of 2010, the ending of the car 'scrappage' scheme, and the effects on travel and trade of the volcano eruption in Iceland.

Almost all surveys report rising confidence, output and exports in Scottish manufacturing. Of the monthly surveys, the Bank of Scotland PMI was the most positive suggesting an acceleration in recovery right across the private sector. Furthermore, the Bank of Scotland Index of Leading Indicators similarly anticipated further recovery in GDP in ensuing quarters. However, the CBI survey - to end April - while anticipating rising output and orders, noted that uncertainty about future demand was likely to limit capital spending over the next twelve months. And the Scottish Chambers Business Survey highlighted the uncertainties posed by weak consumer spending, rising transport and energy costs, Government fiscal and monetary policies, especially the anticipated public spending cuts after the May election. Clearly, the strength and extent of the recovery from the recent major recession is by no means certain.

Forecasts

The Scottish economy came out of recession in the fourth quarter of last year with the recovery seeming weak over the winter months. *The Forecasts of the Scottish Economy* section of the Commentary below notes some evidence of recovery in nominal household expenditure and at a faster rate than we were predicting in February. This may in part be bolstered by evidence of gradually increasing activity in the housing market and some pick up in house prices. But housing market activity - lending for purchases, and house sales - remains weak. Retail sales growth is also not strong with the Scottish Retail Consortium reporting in June that like-for-like sales in May were 0.8% lower than in May 2009,

when they had fallen 1.2%, the worst performance for almost 9 years. The comparable UK data indicated a rise of 0.8%. From this survey consumer confidence appears lower in Scotland than in the UK.

The supply of bank credit remains hesitant. Official Bank of England data for the UK released at the end of May reveals that M4 lending fell by 0.4% in April, with the twelve-month growth rate positive but falling to 2.8% from 3.2% in March. The *Financial Stability Report, June 2010* from the Bank of England indicates that UK banks have increased their resilience with average capital ratios now at their highest levels for more than a decade while leverage has declined considerably. The Bank rightly notes "There is a risk that banks alleviate their own funding pressures by further constraining credit conditions for customers. That would dent economic recovery and so raise credit risk for all banks." (page 10). Sovereign debt risk for the banks has also risen appreciably due to the Greek crisis as fears of spillover to other countries rose. A generalised retreat by the banks from risk-taking would put further pressure on the recovery.

Recovery in Scottish economic growth and jobs is also much dependent on growth in our major markets: the rest of the UK, mainland Europe and the US. Recovery in mainland Europe remains weak and this may be exacerbated by fiscal consolidations in Germany and other major economies. But the IMF is forecasting a significant pickup in world trade in 2010 and 2011 from a fall of -11% in 2009 to increases of 10.6% in 2010 and 8.4% in 2011. Tourism demand remains weak. Some pick up may be expected in 2010 due to the lower sterling exchange rate although recent increases may dampen that effect. We anticipate that tourism spending will remain flat in 2010 returning to growth in 2011 and 2012.

Investment was badly hit during the recession but business investment in the UK had begun to rise again at the beginning of the year. Clearly, the pace of recovery in investment demand will not only be driven by the expected growth of the demand for goods and services but also the availability and price of credit. Confidence remains weak in Scottish construction where much investment activity occurs. But we do expect investment to recover appreciably from the large contractions seen in 2009 but positive growth will not appear until 2011 and 2012.

In many respects the 'elephant in the room' affecting our forecasts for aggregate demand and GDP is the outlook for government spending. We note the expected scale of the spending adjustment below. Through cuts in spending on services, welfare benefits, cost savings and tax increases the government is seeking to rebalance the economy away from government consumption and debt. Government consumption will according to the OBR contribute -0.5% points to UK GDP growth between 2011-2015 compared to +0.5% between 2000 and 2008. But the contribution of private consumption is forecast to be +1.2% points per annum compared to +1.7% between 2000 and 2008. This,

as Martin Wolf points out in the Financial Times (25/06/2010), amounts to a significant increase in the contribution of net exports and investment to realise the OBR forecasts for the period. Specifically, the OBR predicts that net exports and investment will contribute +0.7% points and +1.2% points per annum respectively in the 2011-2015 period compared to +0.3% points and +0.5% points in the 2000-2008 period. It might be achieved but it poses a big challenge for the economy.

Against this background we are now assuming stronger household spending growth than we had assumed in the central forecast for February, export growth to the rest of the world is now significantly higher than previously assumed, while the growth of government spending is weaker.

GVA forecasts

The key forecasts for GVA/GDP are summarised in Table 1 along with our February forecasts for comparison. We shall primarily focus on our central forecast here. Scotland is forecast to return to positive growth in 2010. But the recovery over the year is weak, household spending strengthens and by more than we forecast in February but increases only slightly this year. Exports to the rest of the world continue to recover and at a faster rate than predicted in February. This along with some recovery of investment, helps raise the forecast to 0.7% growth compared to our prediction of 0.6% in February. Recovery is weaker in Scotland than the OBR's forecasts for the UK and the median of independent, private and institutional forecasts for the UK, for the reasons that were well rehearsed in previous Commentaries and we see no basis for altering that view. Scottish GVA growth is better than the UK in 2010 on the High growth scenario only. Trend growth is realised on our Central scenario in 2012 but there is a high degree of uncertainty surrounding our 2012 forecasts because of the large unknowns determining the consequences of the fiscal consolidation.

We have incorporated the decisions on government spending and tax in the emergency Budget into our forecasting model. The most significant changes affecting our forecasting horizon to 2012 are the increase in VAT to 20% and the additional cuts in government spending to that date. IFS analysis indicates that by 2012 less than half of the cumulative fiscal consolidation planned for 2015-16 will be in place. Taken together the consequences of the measures in the Budget lead to our GVA forecast being revised down by 0.1% points in 2010, 0.2% points in 2011, and 0.1% points in 2012 compared to what it would otherwise have been. These changes along with the postponement to 2011 of Scotland's share of the £6bn UK cuts introduced by the new government for 2010 and the fiscal tightening put in place in the March Budget of the Labour government, result in our central forecast for 2011 at 1.1% being 0.5% points lower than our forecast in February. This is despite the fact that wider economic forces driving recovery in 2011 are now considered to be somewhat stronger than was the case in February.

Employment forecasts

The key employment forecasts are summarised in Table 2. Job losses continue from 2009 into 2010, with a net 82,000 jobs lost in those two years and still not fully matched by job gains of 51,000 in 2011 and 2012. At the sectoral level, the service sector experiences the greatest decline in jobs in 2009 and 2010 with under 47,000 net jobs lost. With recovery the net gain in jobs in 2011 and 2012 of 20,000 means that it will take some time for services to recover 2008 jobs levels. Construction job losses amount to around 18,500 over the two years and as with services the number of construction jobs in 2012 remains below 2008 levels but there is recovery in 2011 and 2012 of more than 3,000 jobs. Finally, the production sector which principally includes manufacturing sheds around 13,000 jobs in 2009 and 2010 but through strong export growth net job creation in 2011 and 2012 is nearly 25,000.

Unemployment forecasts

The key unemployment forecasts are summarised in Table 3. On our Central forecast ILO unemployment is expected to peak at 228,000 or 8.9% this year falling to just under 224,000 or 8.7% in 2011 and further to 211,000 or 8.1% in 2012. Of major importance to the outcome for unemployment is not simply output and employment change but also the change in inactivity. That is, the extent to which people losing their jobs cease to look for work and so move into inactivity rather than unemployment. Recent changes in inactivity are documented in the *Overview of the Labour Market* section of the Commentary below. The rate of inactivity appears to have risen during the recent recession by 1.6% points in the last year, to stand at 21.7% for working age people.

Fiscal consolidation and the Scottish economy

The Chancellor's emergency Budget was unprecedented both in terms of the scale and nature of the fiscal adjustment proposed. The scheduled adjustment is significantly greater than that planned by the previous Labour government. The Labour Chancellor, Alastair Darling had aimed to achieve a small, 0.7% of national income, surplus on the cyclically-adjusted current budget by 2014-15. In the light of forecast growth and expected revenues, the Labour government had announced a fiscal tightening amounting to £51bn per year by 2014-15. Within this total, cuts - largely unspecified - of £33 billion were scheduled alongside tax increases of £18bn: a two to one ratio. The publication of the Office for Budget Responsibility (OBR) first set of official forecasts for the public finances and the economy in mid June, revealed that the growth outlook for the UK economy was judged to be weaker than forecast by the previous Labour government. This meant that a greater fiscal consolidation was required to achieve sustainable public finances than that targeted by the previous Labour government. Against this background, the Institute for Fiscal Studies (IFS) estimated that replicating labour's 0.7% surplus goal would

Table 1: Forecast Scottish GVA growth in three scenarios, 2009-2012

GVA Growth (% per annum)	2009	2010	2011	2012
High growth	-4.9	1.4	2.1	2.8
<i>February forecast</i>	-4.7	1.7	2.2	2.8
Central	-4.9	0.7	1.1	2.1
<i>February forecast</i>	-4.8	0.6	1.6	2.2
Low growth	-4.9	0.0	0.1	0.7
<i>February forecast</i>	-4.9	-0.7	-0.3	0.8

Table 2: Forecast Scottish net jobs growth in three scenarios, 2009-2012

	2009	2010	2011	2012
High growth	-48,847	-20,399	35,142	53,059
<i>February forecast</i>	-60,488	-9,785	30,253	57,213
Central	-48,847	-33,546	14,856	36,111
<i>February forecast</i>	-64,218	-32,264	18,277	44,612
Low growth	-48,847	-48,129	-6,036	6,615
<i>February forecast</i>	-77,861	-57,002	-16,538	13,631

Table 3: ILO unemployment rate and claimant count rate measures of unemployment under each of the three forecast scenarios

	2009	2010	2011	2012
ILO unemployment rate				
High growth	7.8%	8.4%	7.4%	6.2%
Central	7.8%	8.9%	8.7%	8.1%
Numbers	202,021	227,820	223,646	210,749
Low growth	7.8%	9.5%	10.1%	10.7%
Claimant count rate				
High growth	4.7%	5.0%	4.4%	3.9%
Central	5.0%	5.3%	5.5%	5.1%
Numbers	138,147	145,143	152,935	144,115
Low growth	5.3%	5.6%	6.0%	6.8%

require a further fiscal tightening of £34bn bringing the total to £85bn or 5.7% of national income. In the event Chancellor Osborne's emergency Budget was even more restrictive with the planned adjustment amounting £113bn by 2014-15, more than 6% of national income.

Our forecasts in the previous section embraced the consequences for growth and jobs of this overall fiscal adjustment to 2012 within the context of other changes in the determinants of aggregate demand and supply over the forecast period. In the section below we report on our

modelling estimates of the possible consequences for public sector output, jobs and the wider Scottish economy by 2014-15 of that part of the fiscal consolidation that lowers by 14% the department expenditure limit (DEL) of the Scottish Parliament and government. In other words, other parts of the fiscal consolidation: tax rises and benefit cuts are ignored, and everything else is held constant i.e. no other changes in the wider economy are allowed such as technical progress and productivity change.

But before we discuss these estimates it is worth rehearsing the options that are available to governments when faced with the need for a significant fiscal consolidation. This is not simply an academic issue now that the broad thrust of the UK cuts have been announced because the Scottish government has still to acknowledge publicly how it will respond to the likely cut in the budget assigned to the Scottish Parliament by the UK government. And indeed, the full scale of the fiscal consolidation facing Scotland will not be known until the Comprehensive Spending Review findings are published by the UK government on October 20th of this year.

Policy Options

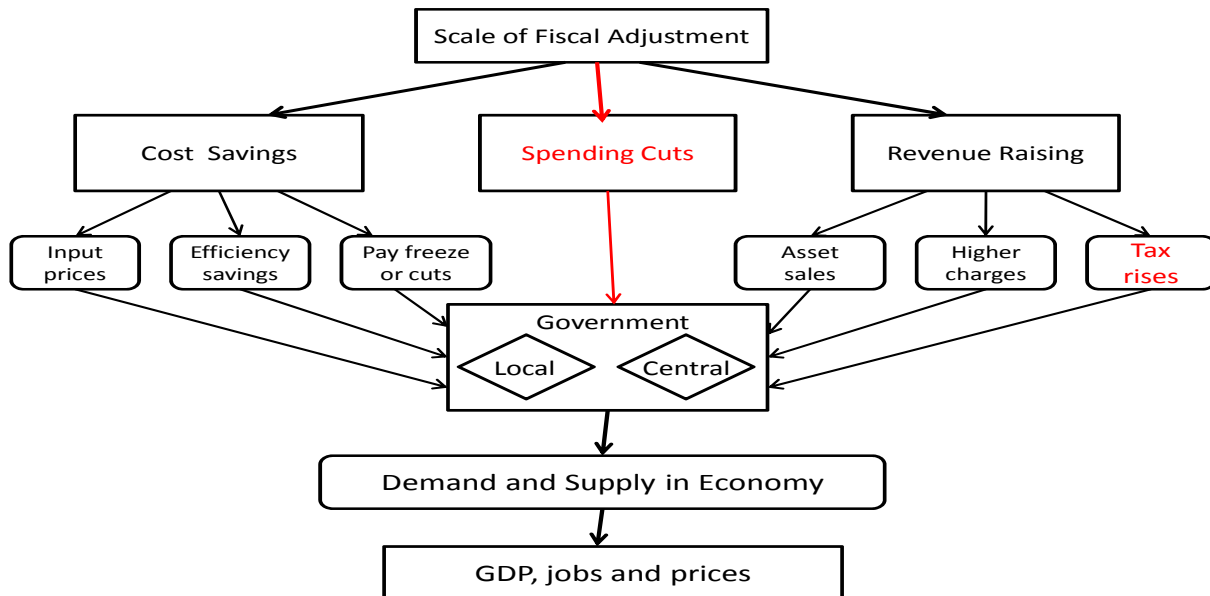
The UK government aims to reduce net borrowing from 11% of national income in 2009-10 to 1.1% in 2015-16. Within overall net borrowing it seeks to reduce the structural (cyclically adjusted) deficit from its 2009-2010 level of 8.4% of GDP to 0.3% by 2015-16. This is a massive exercise, with significant ramifications right across society. A clear consideration of the options available is imperative for both the UK and Scottish governments. In the UK this process had begun with emergency Budget and will continue in the Comprehensive Spending Review. In Scotland the Independent Review of spending chaired by Crawford Beveridge is due to report on spending options. It is to be hoped that the Scottish Parliament and the wider public will have an opportunity to debate not just spending options but some of the other options discussed below.

Figure 7 reveals the broad category options that face governments wishing to undertake a fiscal consolidation. Put simply, the deficit can be reduced by a mix of spending cuts, revenue raising actions and cost savings. Cost savings, in principle, preserve outputs but reduce input costs. Spending cuts cut both inputs and outputs. Most of the UK debate has focused on the balance between spending cuts and tax rises with some efficiency savings also programmed. The Coalition's plans put a greater emphasis on spending cuts with an overall ratio a little below four to one (77% to 23%). Figure 7 shows that there are other options to add in to the mix.

Revenue raising can be secured by higher charges, asset sales and, of course, tax increases. However, asset sales do not reduce spending, or raise revenue recurrently, except marginally on outlays such as maintenance following a

housing stock transfer; they are strictly a one-off exercise. Higher charges do not apparently promise much by way of increased revenue but they are clearly an option that should not be ruled out. Switzerland is one country that has ostensibly low tax rates but this is combined with a charging regime that is much more pervasive than in the UK, or many other countries. The Scottish government's revealed preference of reducing or removing charges - bridge tolls, student fees, prescription charges, travel concessions, care for the elderly - however merited, would appear to make it more difficult for the government to go back down this route. Finally, on revenues, while a debate is developing in Scotland about the case for further fiscal devolution and even full fiscal autonomy it is worth emphasising that under present powers the Scottish government has the option of raising income tax by up to 3p, which would raise more than £1bn. There would clearly be reasoned opposition to such a suggestion but it shouldn't be excluded as a potential option simply because of that. Much the same argument can be applied to business rates, which are also set by the Scottish government.

Cost savings are also possible and can be sizeable as is evident from the programme of public sector pay cuts introduced by the Irish government. Similarly, the UK government plans to freeze for two years the pay of public sector workers with salaries above £21,000 per year. Efficiency savings are realised by 'doing things better'. Such savings may not only be secured by enhanced efficiency in public sector production and/or delivery of services but by selective transfer of production and/or delivery to private sector entities though funded by the tax payer. The CBI has recently made proposals along these lines and the new Westminster Education Secretary's secondary school proposals are of this type, reflecting Swedish experience. In the latter case, the philosophical underpinning of the proposals is that outcomes may be better at given (or less) cost rather than a simple cost cutting exercise. The so-called 'shared-services agenda' at the local government level, as pioneered in the recent Clyde Valley Review chaired by Sir John Arbuthnott, is one way forward to make costs savings while preserving services. There would appear to be many other opportunities in both local and central government for making efficiency savings through the realisation of economies of scale and other efficiencies as the recent (March 2010) Advice Paper prepared by the *Royal Society of Edinburgh* and submitted to the Scottish Parliament's Finance Committee makes clear. For example, we can begin the process by raising the issue whether sufficient cost savings can be achieved by further collaboration and efficiency savings, a strategy noted by the Society of Local Authority Chief Executives in their report 'After the Downturn' and by the Association of Chief Police Officers in Scotland Annual Report 2009/2010, or should Scotland consider more radical options such as the merger of councils, police forces and other public agencies? Several other questions could be posed in a similar vein.

Figure 7: Fiscal consolidation options

Finally, a reduction in *input prices* if the state exerts its power as monopoly buyer may bring some savings for the public sector if not for the economy as a whole. Nothing in this discussion is meant to pretend that spending cuts and tax rises are not the principal route to fiscal consolidation in the UK. But the issues determining the choice of options are more than simply fiscal efficacy. Political, social justice, income distribution and economic growth implications all need to be considered. Different governments may put a different weight on these objectives. Both the previous Labour government and the Conservative/Liberal Democrat coalition have vowed to ring-fence spending on the NHS, and international development aid. As the Emergency Budget revealed, the impact of the cuts on the other spending departments in London has been that much greater, up to 25% depending on the eventual scale of welfare benefit cuts. The IFS note that the cut in DELs born by unprotected departments would rise to 33% if the cuts on the schools and defence budgets are restricted to 10% by 2014-15. The Coalition has also been at pains to highlight the income distributional consequences of its programme for fiscal consolidation, highlighting the extent to which the burden of the adjustment falls more on high income households. The IFS, however, disputes this if the Coalition's additional fiscal consolidation measures are considered separately and when you look past 2012-13 when benefit cuts start to bite.

On top of this is the implication of the fiscal adjustment for the level and growth of output in the economy. Empirical research by Alesina & Perotti in 1996¹, recently updated and confirmed by two Goldman Sachs economists Broadbent &

Daly, highlights the importance of the balance between both spending cuts and tax rises and between certain types of spending cut. Specifically, Alesina & Perotti conclude that "...fiscal adjustments that rely primarily on (current) spending cuts on transfers and the government wage bill..." were more successful in reducing the budget deficit and debt to GDP ratio. However, "...fiscal adjustments relying primarily on tax increases and cuts in public investment tend not to last and are contractionary." These findings offer some support for the Coalition's policy of weighting spending to tax cuts on a 4 : 1 basis. And these findings may even be reinforcing the government's willingness to take risks with the reduction in the demand for goods and services from the public sector in precipitating a double-dip recession. In other words, the research is not inconsistent with the view that the private sector will quickly pick up the released resources as long-term bond yields and the exchange rate falls. But it must be questioned how relevant such empirical research is to the present conjuncture with high levels of unemployment, a sizable output gap, structurally weak bank lending, historically low interest rates and a low sterling exchange rate. However, there may be more general agreement that cuts in public investment, while superficially attractive from a political standpoint with its reduced implications for current service provision and perhaps for jobs losses, could very well be damaging to economic growth. Hence, the previous Labour government's emphasis on cuts in investment in its fiscal consolidation plans, largely adopted by the present government, is to be regretted.

From the above discussion it is evident that the Scottish government has a range of options before it in the difficult

Table 4: Change in sectoral jobs and GVA by 2015 following 14% Scottish DEL cut

	JOBS		GVA/GDP %	
	Fixed Price	Flex Price	Fixed Price	Flex Price
Agriculture	-374	562	-1.1	0.9
Forestry	-14	66	-0.5	1.8
Sea fishing	-4	98	-0.1	2.4
Fish farming	-1	30	-0.1	1.9
Other mining and quarrying	-45	47	-1.8	1.2
Oil and gas extraction	-94	456	-0.4	1.3
Mfr food, drink and tobacco	-408	733	-0.9	1.1
Mfr textiles and clothing	-101	174	-1.0	1.5
Mfr chemicals etc	-108	166	-0.9	0.9
Mfr metal and non-metal goods	-400	927	-0.9	1.8
Mfr transport and other machinery, elec	-181	1,048	-0.3	1.2
Other manufacturing	-702	511	-1.9	1.1
Water	-207	-95	-4.9	-1.8
Construction	-5,003	667	-3.5	0.4
Distribution	-13,974	2,168	-2.6	0.2
Transport	-1,390	1,963	-1.5	1.9
Communications, finance and business	-13,514	3,979	-2.8	0.4
R&D	-384	-53	-4.2	-0.6
Education	-17,959	-14,977	-9.1	-7.4
Public and other services	-71,009	-62,817	-10.8	-8.8
Coal extraction	-30	22	-2.5	1.7
Oil refining and distribution	-36	16	-1.9	0.4
Gas supply	-69	-1	-3.4	-0.2
Electricity - Renewable (hydro and wind)	-27	14	-2.4	0.5
Electricity - Non-renewable (coal, nuke)	-205	120	-2.4	0.8
Total	-126,240	-64,178	-4.2%	-1.6%

decisions it is going to have make in response to an expected large cut in the assigned budget from Westminster. In addition, there is some, all be it limited, evidence on outcomes, not least the economy-wide implications of spending cuts that we present below. We hope that the Scottish Parliament and the wider public will have an opportunity to debate all of these options and build a countrywide consensus on the best way forward.

Impact of cuts in the Scottish DEL

We use a Computable General Equilibrium (CGE) model parameterised on Scottish data to identify the impact on the Scottish economy of the anticipated cuts to the Scottish departmental expenditure limit or DEL by 2014-15². The anticipated reduction in Scottish DEL is taken to be a 14% real cut, which is the average cut to the UK DEL as estimated by the Institute for Fiscal Studies (IFS) in their post emergency Budget analysis³. The size of the actual

reduction is unlikely to be known until the publication of the Comprehensive Spending Review on October 20th. It may differ from 14% somewhat depending on relative size of the cuts borne by the comparable programmes that drive the Barnett formula which allocate the assigned budget to the Scottish Parliament and the cuts borne by reserved programmes.

The CGE model captures the linkages between industries within Scotland and between purchasers of goods and services, including government, produced by industries in Scotland. The model also allows for flexibility in prices, especially wages through local bargaining, and so we offer two simulations: a fixed-price analysis, where the cut in DEL leads to a straight reduction in the demand for goods and services produced in the Scottish economy; a flex-price analysis, where wages and output prices respond to changes in demand. To a certain extent these two

simulations can be viewed as limiting cases defining the likely limits of the economy-wide impacts.

A summary of the results is presented in Table 4. In the fixed-price case, the DEL cut leads to a fall in the demand for goods and services in the public sector and in the wider economy in sectors that are either directly or indirectly linked to the public sector through purchases of inputs or the spending of wages and salaries. The result is output and job losses in both public and private sectors. By 2014-15, public sector job losses amount to nearly 90,000, while private sector job losses stand at nearly 37,000, an overall job loss of 126,000, a reduction in GDP of -4.2% and a fall in investment of -2.9%.

In the flex-price case, the reduction in demand from the public sector will cause real wages and intermediate input prices to fall below what they otherwise would be. This would lower production costs in Scottish industries, improve competitiveness and lead to an increased demand for goods, services and employment, especially in the private sector, on that account, which may serve to offset the loss of demand from the public sector. The improvement in economy-wide competitiveness could, in principle, offset the reduction in output and jobs in the public sector as well. In the event our model estimates that the shock will reduce jobs in the public sector by the slightly lower number of just under 78,000 while private sector employment rises by nearly 14,000. The overall job loss is thus just above 64,000, about half that in the fixed-price case. The fall in GDP is -1.6% more than a third of the loss in the fixed price case. In addition, investment falls by -0.7% but exports rise by 2.1% because of improved competitiveness. There is a 'crowding in' effect on the private sector, but it is insufficient to offset the loss of activity in the public sector.

Table 4 also provides a more detailed breakdown at the sectoral level of the DEL cut. In the fixed price case, the 6 manufacturing sectors lose 1,900 jobs but *gain* 3,559 jobs due to improved competitiveness in the flex price case. The construction sector loses -5,000 jobs in the former case but gains 667 jobs in the latter case. The much larger private service sector, loses 28,878 jobs when there is only a demand reduction effect of the DEL but if regional wages and prices also adjust across the economy then there are net job gains in the sector of 8,110.

Brian Ashcroft
27 June 2010

Endnotes

¹ A. Alesina & R Perotti (1996) "Fiscal adjustment in OECD Countries: composition and macroeconomic effects" National Bureau of Economic Research, Working Paper 5730, Cambridge, MA.

² A version of the AMOS – A Macro-Micro Model of Scotland – computable general equilibrium (CGE) model, which was developed by colleagues in the Fraser of Allander Institute, in the Department of Economics at the University of Strathclyde (Harrigan et al 1991, and Ferguson et al 2003). The AMOS model is a sophisticated simulation model of the Scottish economy with a fully specified supply side, incorporating capacity constraints and endogenous wage and price competitiveness effects.

³ Rowena Crawford "Public services serious cuts to come" IFS, 23 June 2010..

The Scottish economy

Forecasts of the Scottish economy

Economic background

In the four months since our last report in February 2010, several notable developments have occurred which will affect the short- and medium-term growth prospects for the Scottish economy. Most centrally, we have seen data confirming that the Scottish economy saw the first quarter of *positive* GVA growth since Q3 2008. This marked the Scottish economy officially exiting the recession of 2008-9. Most recent UK GDP data report that the UK as a whole was in recession for one quarter more than Scotland, entering recession one quarter before (Q2 2008) the Scottish economy, and exited from recession in Q4 2009. While the recession had a shorter duration in Scotland, output in Scotland fell 6.0% over this period, while GDP in the UK fell slightly less at 5.8%.

The monetary policy response has remained, with The Bank of England's Monetary Policy Committee voting in June to maintain the Bank Rate of interest at 0.5%. It has been at this rate now for fifteen months, since being lowered from 1.0% in March 2009. The use of the Quantitative Easing programme, commenced in January 2009, remained unchanged at £200 billion. The Governor of the Bank of England noted at the launch of the most recent Inflation Report that while inflation continues to be above 3% - and so outside the range set for it in the Bank of England's mandate - this continues to be a temporary outcome, driven by the restoration of VAT to 17.5%, oil price increases and the depreciation of Sterling. Inflation is predicted to remain above target through 2010, and is expected to fall from 2011 as spare capacity pushes prices down, although "the pace and extent of the fall in inflation are highly uncertain, and recent experience suggest there are substantial risks in both directions which the Committee will monitor carefully". That one member of the MPC voted to increase rates in June's meeting shows that one member is concerned about the upside risks to inflation over the coming years.

Since we last presented our forecast for the Scottish economy, the Labour Government presented its Budget in March 2010, and most recently, the Conservative-Liberal Democrat coalition government presented its Emergency Budget on the 22nd of June 2010. In this section we will briefly summarise the changes to planned spending and taxation as announced in the most recent Budget, as it supersedes that which has come before. The extent to which the reductions in Government spending in the coming years - set out in both March and June's Budgets - affects the level of spending by Government in Scotland is unknown at this time. The Scottish Government, for

instance, will only learn its budget for years 2011-12 onwards following the Comprehensive Spending Review which we now know will report on the 20th of October 2010. While headline figures announce that Departmental Expenditure Limits could be cut by an average of 25% in real terms by 2014-15, the budget of the Scottish Government will not fall by this amount, given the ring-fencing of Health spending (an area which has been devolved to the parliament in Scotland).

Headlines from the June 2010 Budget include:

Increasing VAT from 17.5% to 20% from the 4th of January 2010:

- Capital gains tax changes, increasing the rate to 28% for higher rate payers;
- A levy based on the balance sheets of banks active in the UK, including foreign-owned banks (being introduced alongside France and Germany);
- Raising the personal income tax allowance by £1,000 to £7,475;
- The rate of employer National Insurance Contributions will rise by 1% to 3.8% for wages above £131 per week, but no employer NIC will be payable for wages below this figure;
- No further changes to alcohol duty, other than those announced in the March Budget which increase rates in 2013-14 and 2014-15;
- Increasing the basic state pension in line with earnings, prices or 2.5%, whichever is greater;
- Reductions in the rate of corporation tax from 28% to 24% over the four years from 2011;
- Freezing Child Benefit for three years;
- Introducing, from 2011, caps to the payable rates of housing benefit;
- Medical assessments for all claimants of Disability Living Allowances from 2013-14;
- Reducing tax credit eligibility for families with household income greater than £40,000 from April 2011;
- Linking public service pension increases to the rate of change of the CPI, rather than the RPI;
- Review the control and use of accumulated and future revenues from the Fossil Fuel Levy in Scotland.

Although downside risks remain to Scotland's future growth prospects, we forecast that the depths of the downturn seen through 2009 will not be seen in 2010. While the coming years are likely to see a slow and cautious return to growth across Europe, the UK and Scotland, it remains likely that experiences from 2008-2009 will damage confidence across domestic and overseas consumers, and businesses. Further, the unprecedented interventions of policymakers around the world in the use of monetary and fiscal instruments during the 2008-9 recession will have lasting impacts. While the impact of the fiscal and monetary policy responses to the recession will be a source of study for academic economists for many years to come, forecasting

the short-term future requires that we also take account of the second-round of policy interventions: the fiscal policy tightening which will shape the scope and size of the public sector across Scotland and the UK.

We include the decisions from the most recent UK budget in the forecasts presented. The most significant changes affecting our forecast horizon to 2012 (and so not including changes which occur from 2013 onwards) are the increase in VAT and the larger than expected anticipated reductions in government spending. Taken as a whole, we estimate that the measures in the budget have revised down our GVA growth forecast for Scotland for 2010 and 2011 by 0.1% and 0.2% to now stand at 0.7% and 1.1% respectively in our Central scenarios.

We examine the possible impact of solely the government spending reductions on the Scottish economy in a section which follows the *Forecast* section of the commentary. Specifically, we use a Computable General Equilibrium model of Scotland to quantify the possible impact on the Scottish economy of the changes to government spending in Scotland. This shows the extent to which not only the public sector, but other sectors which rely upon the public sectors for sales, or on the spending of workers in the public sector, could be hit by the changes in the levels of public spending.

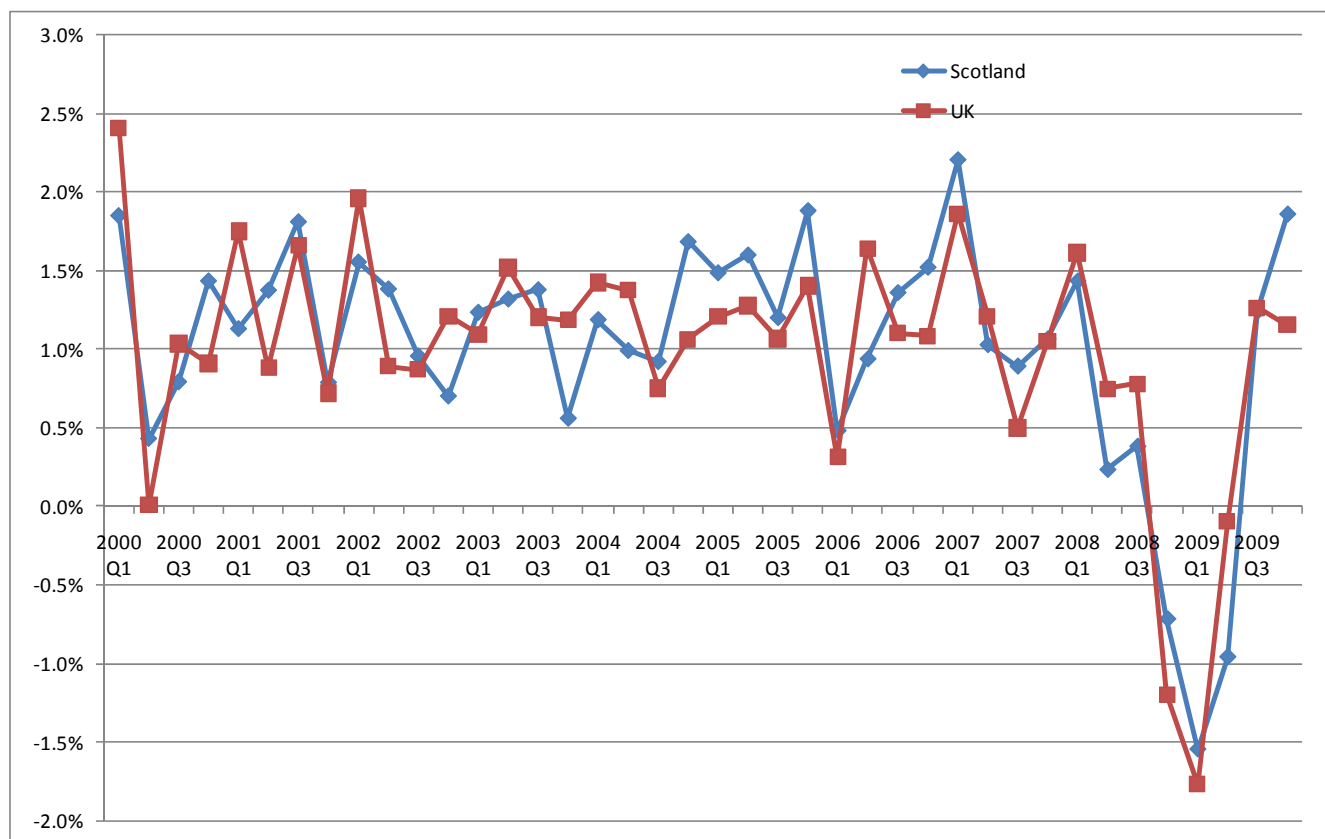
The Scottish economy

In the last quarter for which data are available (Q4 2009, published on 21st April 2010), the Gross Value Added (GVA) in Scotland rose by 0.2% from the previous quarter (Q3 2009). This marked the first quarter of positive growth since Q3 2008, and officially moved Scotland out of recession. Scotland entered recession following the second consecutive quarterly decline in GVA in Q4 2008 and saw five quarters of negative GVA growth.

The Scottish manufacturing sector, accounting for 14.1% of Scottish GVA, was up slightly (1.2%) over the final quarter of 2009, albeit that this sector has seen a decline of 9.6% over the year to Q4. Unlike the Scottish economy as a whole, this sector registered its second consecutive quarter of GVA growth since Q2 2008. GVA in the manufacturing sector is down 10.4% from its Q2 2008 peak. Within the Production sectors of the Scottish economy more generally, the largest quarterly and yearly decline continues to be seen in the Mining and quarrying industries (down 14.0% on the previous period). These industries, counting for 1% of Scotland economy, last registered a positive period of growth in GVA in Q2 2007.

Construction in Scotland (accounting for 6.5% of GVA) was down 2.8% on Q3 2009, and down 10.8% on the year. In all, the sector was down 15.2% on the peak seen in Q2 2008.

The Services sector (responsible for 74% of Scottish GVA, and 83% of the jobs in the Scottish economy in December 2009) grew by 0.2% in Q4 2009 – largely producing the

Figure 1: Quarterly nominal change in domestic household expenditure, Scotland and the UK Q1 2000 to Q4 2009

return to growth displayed by the economy as a whole during the quarter. The sector was down 3.6% in 2009 compared to 2008. Several points should be evident from the analysis of the sectors which have suffered. Firstly, all sectors saw declines, with a hollowing out of activity in production and manufacturing sectors. This recession has been no respecter of history or heritage in the sectors affected. Secondly, any retrospective analysis will need to consider the extent to which the industrial structure affected the ability of regions to weather the economic storm.

Labour market developments in Scotland to the end of April 2010 (published in June 2010) showed falling employment and increasing unemployment over the year and the most recent quarter. Between February and April 2010, employment of those aged over 16 stood at 2,432 thousand, down 83,000 (or 3.3%) on the same period one year previously. The majority of this fall in employment was seen in the most recent quarter, with employment falling by 47,000. The employment rate for those of working age (16 to 59 (for women) and 16 to 64 (for men) fell by 1.3 percentage points, falling from 73.1% to 71.8%. Rising labour market inactivity has been a feature of the Scottish labour market over the recent past, and the most recent quarter saw a rise in working age inactivity of 54,000, pushing the working age inactivity rate from 20.6% to 21.7%. There are currently almost 700,000 people of working age population not economically active in Scotland.

The data on inactivity suggest that increases in inactivity rates are especially high in the 16-17 age group, and males 18-24.

Looking at unemployment, the number of people over the age of 16 who were unemployed rose by 7,000 compared to the previous three months. The rate of increase in unemployment slowing from a 16,000 increase in unemployment in the previous three months. Over the last year, the numbers of unemployed rose by 34,000. As of February to April 2010, the ILO level of unemployment stood at 212,000. The preliminary estimate of those receiving unemployment-related benefits – a more up to date, but less complete, measure of unemployment than the ILO definition - stood at 134,000 in May 2010.

While the number receiving unemployment benefits has fallen 5,000 since January 2010, and the rate of those in work or receiving benefits who do receive benefits has reduced from 5.0% to 4.8% over these five months, the level of “claimant count” unemployment is nine thousand higher than May 2009. Over the year, more women than men have begun receiving unemployment-related benefits (4,800 women versus 4,200 men), and the aggregate picture of falls in the number of claimants since January 2010 appears to be driven by the movements of the male, rather than female, claimants: whose numbers have increase month on month since the start of 2009.

Final demand and recent trends

The Fraser of Allander Institute (FAI) forecasting model acknowledges the drivers of economic activity in the Scottish economy to be consumption, government spending, investment, tourism and exports (to the rest of the UK and the rest of the World). For all three scenarios considered, the recent trends in each of these measures, and most recent survey evidence, are discussed below.

Consumption

Data being developed by the Scottish Government through the Scottish National Accounts Project (SNAP) were published on 21st April. These showed that Q4 2009 saw a small upward rebound in nominal household expenditure, following three quarters of reductions. These figures are in 'Nominal' terms however, so the real increase in spending will be lower, and may be negative. This confirms the evidence from previous quarters that the reduction in household expenditure is moderating, but it is unlikely that this small positive growth in nominal expenditure is signalling a return to previously strong positive growth in Scottish household consumption expenditure. Figure 1 shows the different patterns in quarterly nominal spending in Scotland and the UK since 2001. We can see clearly from this that in both Q3 and Q4 2009 nominal household spending increased in Scotland and in the UK. Note however that various measures of RPI inflation (excluding mortgage and/or housing costs in the final quarter of 2009 were between 2.8 and 3.4%). As noted in the last commentary, it is unclear how significant the return of VAT to 17.5% from the 1st of January would cause household spending to be brought forward to Q4 from Q1 of 2010.

As previously noted in *Forecasts*, household credit facilities have been crucial for the recent growth of household expenditure, and in the movement of the Scottish economy towards a more service-oriented structure, and the provision of goods for household consumption.

The decline in the availability of credit facilities to households, as well as households continued reluctance to take on credit in uncertain economic conditions as they rebalance and pay down debts, will continue to dampen household spending. The link between house prices growth and household spending is anecdotally important, and recent increases in house prices reported by the surveys of the Scottish housing market may indicate the beginnings of a return to growth, although total house sales remain weak, and bank lending capacity is forecast by the IMF to contract in 2010. Figures from the Council for Mortgage Lenders showed that lending for purchases of new homes in Scotland during the first three months of 2010 was 33% lower than the same period in 2009, with 9700 loans worth £1.1 billion advanced. As with the VAT point above causing spending to be brought forward into 2009, the CML notes that the decline in Q1 2010 might have been caused by the ending of the Stamp Duty "holiday" on properties up to £195,000 which ended in December 2009. While loans for home purchases are up on the lows of one year previous,

the remortgage market remains sluggish with the number of loans down 36% on Q1 2009. Before the turn of the year, gross mortgage lending in the UK was well below half the levels seen throughout 2007. This demonstrates the devastating impact on the housing market of the "credit-crunch".

Figures released on the 19th of May 2010 by the Scottish Retail Consortium reported continued challenges across the sector, with the weakest like-for-like sales performance in April since March 2000. All categories of retail sales suffered, with food and non-food sales seeing like-for-like declines of 3.1% and 0.9%. It will be crucial for the path of the retail sector, and consumer expenditure more generally, that February and future months figures indicate whether figures since the start of the year are indicative of part of a longer term rebalancing of household balance sheets. This appears to be borne out by the most recent data here – albeit that total household spending in Q1 is not yet available. The most recent survey evidence (see the review of business surveys section), largely capturing small and independent retailers, continues to indicate declining business confidence and anticipates declining sales through not only the first half of the year, but continuing throughout 2010.

Government spending

As noted in previous *Forecasts*, UK fiscal policy measures enacted during 2008-9 and 2009-10 provided a stimulus designed to support activity and employment through the declines in growth seen in late 2008 and 2009. Similar packages were instigated across the world in response to what was a global downturn, in practice, stepping in to offset the increase in the household savings rates as consumers pegged back spending rapidly. Further, all UK political parties campaigned during the recent elections to the Westminster parliament for the need for a programme of real terms aggregate spending reductions over the lifetime of the new parliament as government deficits were to be reduced, and UK government debts repaid. The annual government deficit – the difference between spending and income – was predicted in the OBR's June (Pre-Budget) forecast at £156 billion (11.1% of GDP) for 2009-10. While £73 billion pounds of tax and spending changes designed to bring down UK government deficit had been announced in the March budget, the June Budget announced a further £40 billion of consolidation over the next five years. June's Budget set out the UK Government's fiscal target is to have balance in the current budget by the end of the five-year forecast period.

The UK Conservative-Liberal coalition government set out in some detail its immediate plans for government spending in a budget on the 22nd of June, and will carry out a Comprehensive Spending Review which will report in October 2010. These will set out a programme of (aggregate) public spending reductions, however the "devil will be in the detail" on a number of issues, particularly over the impact that reductions in UK government spending will

have on the “block grant” budget of the Scottish parliament in the short-term. We should know this in more detail following October’s spending review. Longer term, both members of the UK coalition government appear to have accepted that there might be a case for examining the (fiscal, as well as other) powers of the Scottish Parliament as set out the Calman Commission on Scottish Devolution (which reported in June 2009). This recommended options for “tax sharing” between Scotland and the UK, with the headline proposal on income tax recommending that a “Scottish variable rate of income tax” be introduced, the revenues from which would finance spending by the Scottish parliament, with an offsetting reduction in the Barnett-formula calculated block grant given to the Scottish parliament.

Our forecasts capture the extent to which government spending is felt across the economy, and the knock-on impacts on activity and employment at the sectoral level of changes in the sectors whose output is important for the demands of the public sector. Put simply, the forecasting model will see reductions in government spending as directly affecting the public administration, education, health and social work sectors, and at the same time affecting those sectors which rely on public service sectors for the destination of their outputs (which could include suppliers to the public sector in the private business sectors). The scales of public spending reductions which are being discussed would suggest that in level terms, expenditures by the public sector will be reduced in the short-and medium-term, and that this will impact on activity, and likely employment, in sectors across the Scottish economy.

In a report released in April 2010, Scotland’s Chief Economic Advisor set out some scenarios for Scottish Government expenditure beyond the current year (2010/11). This report, carried out in advance of the UK June Budget, and so did not have access to the more detailed proposals for UK Government spending, nevertheless showed that the outlook for public expenditure is bleak. UK Department Expenditure Limits (DEL) are projected to fall by 3.0% on average per year in real terms between 2009/10-12 and 2014/15 or by 12.4% overall. Under the Barnett-formula allocation mechanism for Scottish DEL funding, the report argues that (if the UK reductions were equally shared across UK government departments) that Scottish Government expenditure could fall by 2.9% in real terms on average per year. This follows a period since 2000/1 and 2009/10 in which Scottish Government DEL has growing on average in real terms by 5% per year. The true extent of the reductions in Scottish Government DEL will depend upon the extent to which the reductions in UK DEL is felt by departments for which responsibility in Scotland has been devolved. Simply, real terms reductions to the armed forces budget, for instance, do not have a “Barnett consequential” for the DEL in Scotland since these are reserved to the UK parliament, but reductions in the budget for education—which is under the control of the Scottish Parliament in Scotland – would cause changes in the Scottish DEL

funding available. Nevertheless, there is much to suggest, and would be consistent with recent IFS analysis, that the measures in the June budget could imply a reduction in real terms of 14% in Scottish Government DEL between 2009/10 and 2014/15.

In the GVA growth and labour market forecasts published in this *Commentary*, we include a range for Government spending in Scotland over the next three years. We intend these to capture the range of possible changes to government spending in Scotland, although we note that, even after the Budget on the 22nd of June, there are uncertainties about the extent to which changes which will follow from the Autumn UK Spending Review will feed through to the budget available to the Scottish Parliament. In all three of the forecast scenarios real government spending in Scotland falls in all three scenarios in 2011 and 2012.

Investment

As previously noted, there are no separate National Statistics on investment in Scotland. Business investment figures reported for the UK, which may typically be expected to be broadly indicative of the path of investment in Scotland, show in Q1 2010 the first upward growth in business investment seen since Q2 2008. Total business investment in Q4 2009 was up 6.0% on the previous quarter, but still down 11.0% on Q4 in 2008. The sectoral changes in investment continue to support the idea that manufacturing sectors have been hit particularly hard, with total business investment by the manufacturing sectors continuing to decline on the last quarter, down 29.3% on Q4 2008, and approximately two thirds of the levels seen through 2006-2008. Non-manufacturing investment was up 6.7% in the quarter, with increases in Construction (27.9%) and Other services (9.3%). Investment by Public Corporations was down 3.1% in Q4 2009, and down 18.9% on Q4 2008.

Tourism

Elsewhere in the *Commentary*, we report weak confidence in the tourism sector across Scotland, with declines in employment (full-, part-time and seasonal) as well as declining overtime. Most recent figures for the UK, published in June 2010, show that in the first three months of 2010 the number of visitors from overseas to the UK fell by 5.0%. Average occupancy figures in Scotland in February and March remained similar to previous years, while there were declines in the use of restaurant and conference facilities, perhaps caused by declining spending by Scottish and non-Scottish businesses. Most recent data for April suggests a slightly lower average occupancy than in the same month in previous years. The extent to which discounting continues to be used to support the sector through Q2 and into the summer months will have a crucial role in the outlook for the sector in the short term. While short-term factors such as the Icelandic volcanic ash disruptions, the harsh winter weather, rising fuel costs could mitigate or have ceased,

and the sector could benefit from the weak exchange rate over the coming months.

Exports to the rest of the UK

Preliminary estimates of GDP growth for the UK in the 1st quarter of 2010, published on the 22nd of April 2010, revealed that growth continued for the second quarter, up by 0.2%, somewhat lower than many analysts had predicted. As noted before, the rest of the UK is the most important trading partner for Scottish industries, the future for demand for Scottish exports will depend crucially on the path of growth which occurs in the UK. Scottish IO tables for 2004 – the most recent year they are available – showed that exports to the rest of the UK were approximately double exports from Scotland to the rest of the World.

Recent forecasts for GDP growth in 2010 in the UK show a strong rebound from the declines seen in 2009. The newly-formed Office for Budgetary Responsibility's forecast in the Appendix to June's Budget document indicated that following a 4.9% decline in 2009, growth in the UK would return to positive in 2010 at 1.2%, and in 2011 and 2012 show a stronger growth performance of 2.3% and 2.8% respectively. Household consumption growth is forecast to remain weak, rising by only 0.2% in 2010, and reaching growth of 1.7% in 2012. Much of the growth forecast for the UK comes from strong forecasted growth in exports of goods and services from the UK to the rest of the world: forecasted to rise 4.3% in 2010, 5.5% in 2011 and 6.3% in 2012. These forecasts for UK household spending growth have been revised down in the light of the proposals in the June UK Budget.

As noted elsewhere in this edition of the *Fraser Economic Commentary*, Scottish Chamber and CBI respondents reported rising trends in expected export orders in Q1 2010, although demand from the rest of the UK remains fragile, and suggests a stronger upturn in orders and exports in Q2 2010.

Exports to the rest of the world

Recent forecasts for the growth in world trade were produced by the OECD in May 2010. Overall, world trade, which fell by 11.0% in 2009, is predicted to increase by 10.6% in 2010, and to grow by 8.4% in 2011. Alongside this, the IMF forecasts from April 2010 predict world output to increase by 4.2% in 2010, and 4.3% in 2011. The growth in markets for Scottish goods will be an important driver of the extent to which exports can drive the economic recovery.

As noted in previous *Forecasts*, Scottish exports have traditionally gone to other EU and other "advanced economies", which the IMF forecasts will grow by 1.0% in 2010 and 1.7% in 2011. The major traders for Scotland, and the recent forecasts for growth in these areas, are given in Table 1 below. Whilst the further development of existing destinations for Scottish goods and services is vital to the export-led recovery for Scotland, opening up previously

underdeveloped markets could offer greater scope for economic gains over the next three years.

Despite upward revisions for the major (non-UK) destinations for Scottish exports, growth continues to be forecast to be relatively slow to return in 2010, particularly for the advanced EU economies to which Scotland has traditionally exported its non-UK exports. It is in developing (European and non-European) countries that the highest forecasts for growth through 2010 and 2011 are found, and the success of an export-led recovery for Scotland may depend on the speed at which new markets in these previously less important export destinations can be found.

In past forecasts we have used experimental statistics on the manufacturing exports to the rest of the World by quarter produced by the Scottish Government as part of the Scottish National Accounts Project. The most recent data, published in April 2010, cover the period from Q1 2002 to Q4 2010. These data showed that over the year to the end of the 2009, Manufacturing exports from Scotland – which account for roughly two-thirds of Scottish exports to the rest of the world – fell by 10.1% in real terms (stripping out the impact of inflation). Having seen an increase in Q3 2009 manufactured exports (as commented on in the last *Forecast*), we saw a further increase in exports in Q4. This shows the extent to which the 2009 annual trade figures are hit by the collapse seen in Q1 and Q2 2009. Over 2009, the only sector for which results are separately reported to see an increase in manufactured exports to the rest of the world was the Food and drink sector, up 0.8%. The largest declines in percentage terms was seen in Metal and metal products (down 24.7%), with the largest absolute decline in exports to ROW in the Engineering and Allied Industries (down £948 million in 2005 prices).

The most recent survey evidence for the Scottish Manufacturing sector reports upward trends continuing in total orders, with exports trending upwards. Across manufacturing survey suggest that the worsening conditions seen through the first half of 2009 have ended, and while confidence is weak, upwards trends are anticipated through Q1 and Q2 2010.

The forecasts: Background

As with the forecasts published in the last five Economic Commentaries, we give three alternative scenarios for growth, employment and unemployment in the Scottish economy between 2010 and 2012. We give a "Central" case, with "High growth" and "Low growth" as two respectively upper and lower growth alternatives. We intend that these three scenarios capture the range of outcomes that are possible, given that there are considerable uncertainties surrounding any specific single or point estimates to the "Central" forecast, especially in 2012. The significant revisions to Scottish GVA growth discussed in the last commentary – which has been a particular feature of the 2008-9 recession - suggests that using a scenarios approach is sensible when first estimates of growth may be

Table 1: GDP growth forecasts for top five export markets for ROW exports from Scotland, % year on year change, plus United Kingdom and Euro Area

		2010		2011	
		IMF (May 2010)	OECD (May 2010)	IMF (May 2010)	OECD (May 2010)
1	United States	3.1%	3.2%	2.6%	3.2%
2	France	1.5%	1.7%	1.8%	2.1%
3	Germany	1.2%	1.9%	1.7%	2.1%
4	The Netherlands	1.3%	1.2%	1.3%	2.0%
5	Ireland	-1.5%	-0.7%	1.9%	3.0%
	United Kingdom	1.3%	1.3%	2.5%	2.5%
	Euro Area	1.0%	1.2%	1.5%	1.8%
	Advanced	1.0%	n/a	1.7%	n/a
	European Economies				
	Emerging	3.3%	n/a	3.4%	n/a
	European Economies				

Sources: *International monetary Fund, Regional Economic Outlook: Europe, Fostering Sustainability, May 2010 and International Monetary Fund, Regional Economic Outlook: Western Hemisphere, Taking Advantage of Tailwinds, May 2010 and World Economic Outlook Update, January 2010, and OECD Economic Outlook, May 2010.*

revised (sometimes, significantly) some quarters into the future.

While we do not give explicit probabilities for each of these outcomes, we see the “Central” scenario as being that which is most likely, while “High growth” and “Low growth” reveal the possible range of outcomes for the Scottish economy from 2010 through to 2012.

The forecasts: Detail

In the three scenarios considered, the following features are assumed to influence the factors of demand, and economic activity, across the Scottish economy:

Household

In the “Central” scenario, we forecast that the significant reduction in Household spending seen in 2009 moderates, but overall expenditure growth only increases slightly in 2010, in part due to expenditure brought forward from 2011 when VAT will be higher. This can not bring forward purchases of non-durable items, such as food, for example which mitigates this effect being larger. Aggregate Household expenditure in 2011 and 2012 is forecast to increase slightly from weak 2010 levels, although spending growth in 2011 is damaged by the VAT increase and only by 2012 does household spending return close to trend expenditure growth. In “Low growth”, household expenditure is damaged through lower consumer confidence, persisting

job security fears and low wages growth. Household spending falls through 2010 in the low growth scenario, however less than was seen in 2009, and returns to flat growth in 2011 in this scenario. As with previous scenarios, it isn't until 2012 that household spending sees a return to positive growth in “Low growth”. In “High growth”, spending responds faster than in “Central”, returning to sluggish, but positive, growth in 2010 before seeing a return to pre-2008 trend expenditure growth through 2011 and increasing marginally above trend in 2012. This scenario would be consistent with outturn unemployment increases being lower than anticipated, and household spending recovering through access to, and increased demand for, credit facilities.

Government

In “Central” we forecast an increase in government spending in Scotland through 2010 on 2009 levels, but this is the final year of government spending growth expected for the short-term. The Scottish Government has delayed making the reduction in aggregate spending from this current financial year, but the reduction in 2011 will be greater as a result. From 2011, we forecast annual real terms reductions in aggregate Government spending in Scotland, which are reduced by 4.2% in 2012 compared to 2011, and 4.5% lower in 2011 on 2010. In “High growth”, government spending is still lower in 2011 and 2012 compared to the previous year's total, with less tightening

across government budgets at the UK level in comparable spending programmes. Across all scenarios however, government spending in Scotland is lower and this will directly impact on the sectors and industries in which public spending in Scotland supports activity and employment. In the “Low growth” scenario, government spending falls in 2012 by close to the reduction seen in 2011.

Exports

In “Central” we anticipate a slow return to growth in world trade in 2010, with a return to strong positive growth in demand for Scottish exports from the rest of the world returning through 2011 and 2012, in part due to the increased competitiveness of Scottish products from the weakening in the value of Sterling over the last two years. In “High growth” and “Low growth”, this return to positive growth in exports to the rest of the world from Scotland takes less and more time, respectively. Exports to the rest of UK follow a similar pattern returning to slightly positive growth in 2010 across all three scenarios, albeit that, due to the measures introduced in June’s budget, growth in domestic demand in the rest of the UK is forecast to be lower in 2010 and 2011 than it otherwise would have been. In “Low growth” we forecast a small increase in export demand from the rest of the UK in 2010.

Tourism

Tourism is forecast to recover slowly from the challenging conditions seen through 2008 and 2009, largely driven by (non-Scottish) households reducing expenditure on travel and tourism activities (in line with domestic households experiences of reduced overseas travel). In “Central”, tourism spending in aggregate is forecast to remain flat in 2010 – in line with household spending growth – and returning to growth in 2011 continue through 2012.

Investment and stocks

As discussed above, 2009 saw reductions in investment demands which were unprecedented in modern times. As we have previously stated, the recovery in investment will be partly driven by the supply of credit, but also the demand for credit from companies, which will be linked with returning business confidence. Recent survey evidence for Construction, responsible for much of the investment activity in the Scottish economy, continues to show weak levels of overall confidence, with declines in order, albeit more slowly than seen previously. We forecast in “Central” that aggregate investment levels will return from the huge declines seen through 2009, but will show positive growth from 2011 and 2012. “High growth” sees investment increasing from 2009 levels in 2010, although the increase is forecast to be small.

Evaluation of earlier forecasts

February 2010’s forecast for GVA growth in Scotland 2009 under all three scenarios presented in the last Commentary was negative, and significantly so, ranging from -4.6% to -4.8%. We forecast the GVA change at the end of the (calendar) year when compared to the four quarters of the

year before. Thus, for comparison the GVA forecast made now for 2010 can be evaluated against the GVA for Scotland in 2010 which will be first released with the publication of Q4 2010 likely to be around April 2011. The April 2010 release of Q4 2009 allows us to compare earlier forecasts to outturn data, which was for a decline in Scottish GVA of -4.8%, and thus in line with our “Low growth” forecast for Scotland published in February’s Commentary.

As readers of previous Forecasts will be aware, forecasters not only in the UK but across the world largely failed to predict the speed and depth of the 2008-9 recession. Equally forecasters, including the newly formed Office for Budget Responsibility, have had to revise their forecasts for 2010 and 2011 in light of the June budget. We will produce evaluations of the forecasts we have made over the last two years and report on these in a future issue of the Commentary (once revisions to data are smaller, and we can have confidence in the outturn). For comparison to earlier forecasts, our “Central” growth scenario for 2009 released in November 2009 was for -5.0% growth to be seen in 2009.

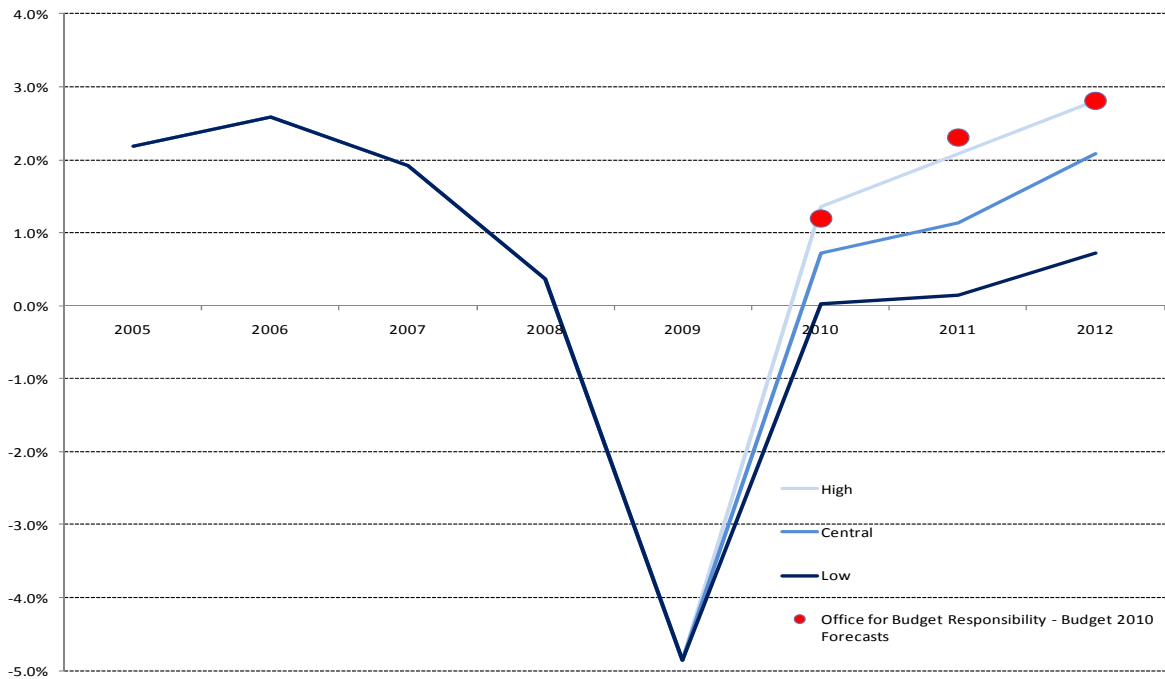
Results

Gross Value Added

All three scenarios forecast out to 2012, by which time Scottish GVA growth in all scenarios is forecast to be positive. The recovery to positive growth occurs faster in the High growth scenario, and more slowly in the Low growth scenario. As stated above, we forecast that the Central scenario represents the most likely outcome for the Scottish economy given the current economic position and outlook at the start of 2010. Scotland is forecast to return to positive growth in 2010 in both the Central (0.7%) and High growth (+1.4%) scenario, and the Low growth scenario sees no growth (0.0%) in 2010 and positive growth in 2011 (0.1% respectively). As are noted above, considerable multiple downside risks remain to the strength of the expected economic recovery for Scotland.

These scenarios are presented in Figure 2, alongside (for comparison) the forecasts for the UK as a whole in 2010, 2011 and 2012 made by the Office for Budget Responsibility (OBR) (and published alongside the Budget on the 22nd of June 2010). Forecasts for the economic growth of the UK in 2010 and 2011 were collected by HM Treasury in June 2010, and the median of independent, private and institutional forecasts for UK GDP growth for these years are the same as those published by the OBR in its forecasts.

We are forecasting that the Scottish economy will perform better than the OBR’s forecasts for the UK in 2010 (1.2%) under the High growth scenario only, but less well under the most likely Central scenario. The average of recent independent forecasts for growth of the UK economy in 2010 has been revised downwards over the months since May 2010 from 1.4% to 1.2%. We anticipate the most likely

Figure 2: GVA growth 2008 and forecasts to 2012, Scotland and the UK

outcome in light of the June budget proposals is for a slower return to growth in Scotland than the UK as a whole, with our Central scenario forecasting lower growth in Scotland than the OBR forecasts for the UK in each year from 2010 to 2012.

Under the Central scenario, GVA growth returns to positive annual growth in 2010 (+0.7%) and 2011 (+1.1%). In 2012, Scottish growth is forecast to be 2.1%, slightly above long-

term trend growth for Scotland, and marginally down from our forecast for 2012 in February 2010. Our headline forecast in the "Central" scenario, and the forecast for the broad sectors under this scenario are given in Table 2. Table 3 shows the GVA forecasts under each of the three scenarios. Under the Low growth scenario, negative growth is also seen in 2009, 2010 and 2011, with the Scottish economy not returning to positive growth in this scenario until 2012.

Table 2: Forecasts of the Scottish economy (Central scenario), 2010-2012

	2010	2011	2012
Gross Value Added	0.7%	1.1%	2.1%
Manufacturing	1.6%	3.2%	5.3%
Construction	0.6%	0.8%	1.5%
Services	0.7%	1.0%	1.9%

Table 3: Forecasts for aggregate GVA growth in the Scottish economy under three scenarios, 2010-2012, %

	2010	2011	2012
High growth	1.4%	2.1%	2.8%
Central	0.7%	1.1%	2.1%
Low growth	0.0%	0.1%	0.7%

Table 4: Forecasts of Scottish employment (jobs, 000s) and net employment change in central scenario, 2009-2012

	2009	2010	2011	2012
Total jobs (000s), Dec	2,336	2,303	2,318	2,354
Net annual change (jobs)	-48,847	-33,546	14,856	36,111
% change from previous year	-2.1%	-1.4%	0.6%	1.6%
Agriculture (jobs, 000s)	28	28	28	30
Annual change	-3,906	-140	716	1,340
Production (jobs, 000s)	239	238	248	263
Annual change	-12,280	-789	9,200	15,606
Services (jobs, 000s)	1,947	1,916	1,920	1,936
Annual change	-15,800	-30,872	3,478	16,543
Construction (jobs, 000s)	122	121	122	125
Annual change	-16,861	-1,745	1,462	2,622

Note: Figures are numbers of employee jobs, by industry, and not the numbers in employment, therefore these figures differ slightly from those reported in the labour market section of the Economic Commentary.

Table 5: Forecast Scottish net jobs growth in three scenarios, 2010-2012

	2010	2011	2012
High growth	-20,399	35,142	53,059
Central	-33,546	14,856	36,111
Low growth	-48,129	-6,036	6,615

Table 6: Forecasts of Scottish unemployment, Central scenario 2010-2012

	2010	2011	2012
ILO unemployment	227,820	223,646	210,749
Rate1	8.9%	8.7%	8.1%
Claimant count	145,143	152,935	144,115
Rate2	5.3%	5.5%	5.1%

Notes to Table 6: 1 = rate calculated as total ILO unemployed divided by total of economically active 16+ population. 2 = rate calculated as claimant count divided by sum of claimant count and total jobs. The latest estimates figures forecast in Table 6 were published in June 2010 in the Labour Market Statistics First Release for Scotland. These estimated the ILO unemployment levels and rates for the three months to April 2010 as 212,000 and 8.0% respectively. The same publication gave preliminary estimates of the claimant count and rate for May 2010 as 134,000 and 4.8%.

We present forecasts for GVA change in Scotland at broad industry levels for production and services, as well as the construction sector, under each of the three scenarios – Central, High growth and Low growth. Figure 3 shows the GVA change in Manufacturing under each of these three scenarios, while Figure 4 shows the GVA change in Services. Figure 5 shows the change in forecasted GVA in the Construction sector between 2009 and 2012. Across Production (shown in Figure 3), a recovery from the observed declines in GVA in 2009 occurs in 2010 in the Central and High scenarios. There is GVA growth of 3.1%

forecast for 2010 under the High growth scenario. The Low growth scenario on the other hand forecasts a (very) slight decline in GVA in Production this year. In 2011 and 2012, all three scenarios forecast positive GVA growth in the Production sector, with growth ranging from 0.9% to 5.3% in 2011 and 2.2% to 6.7% in 2012.

Figure 4 shows that Service sectors GVA growth across the three scenarios is more insulated to the economic downturn than the Production figures seen in Figure 3. Services GVA

Figure 3: Forecasts of GVA growth in Production, 2010-2012

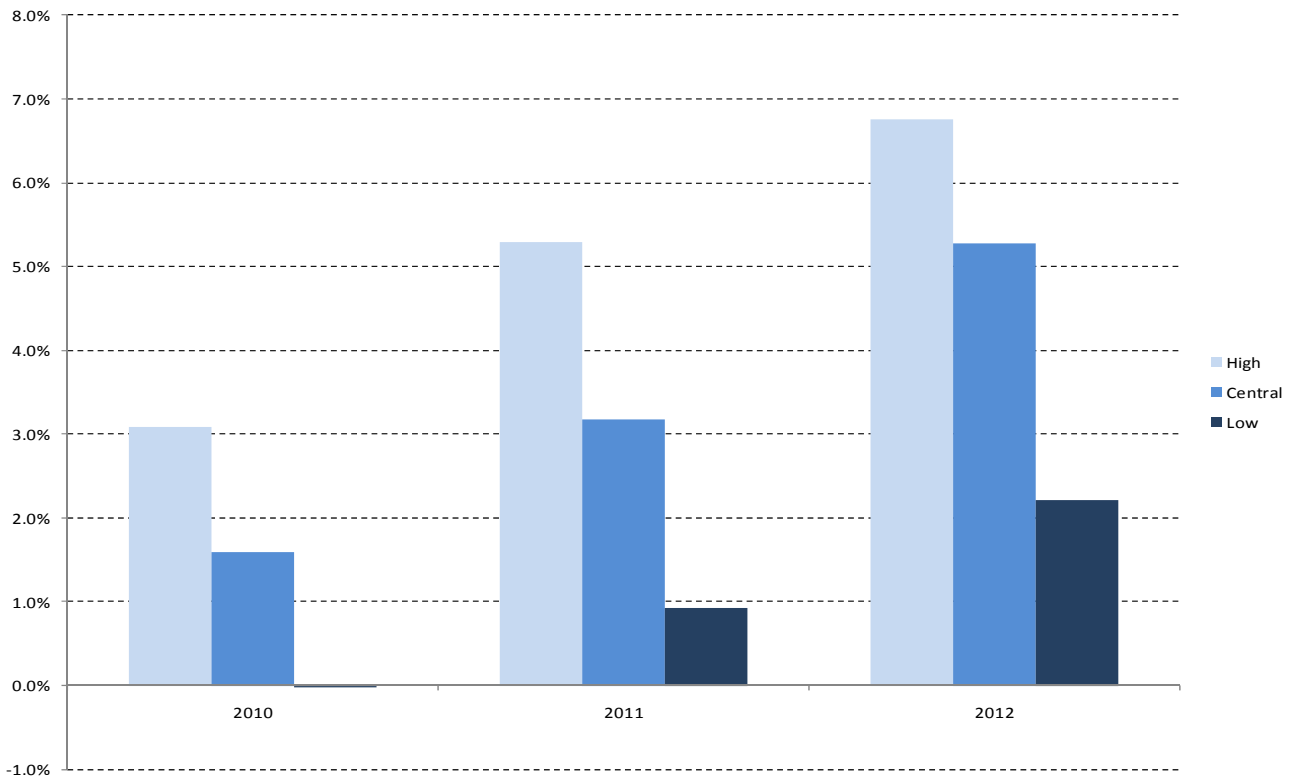
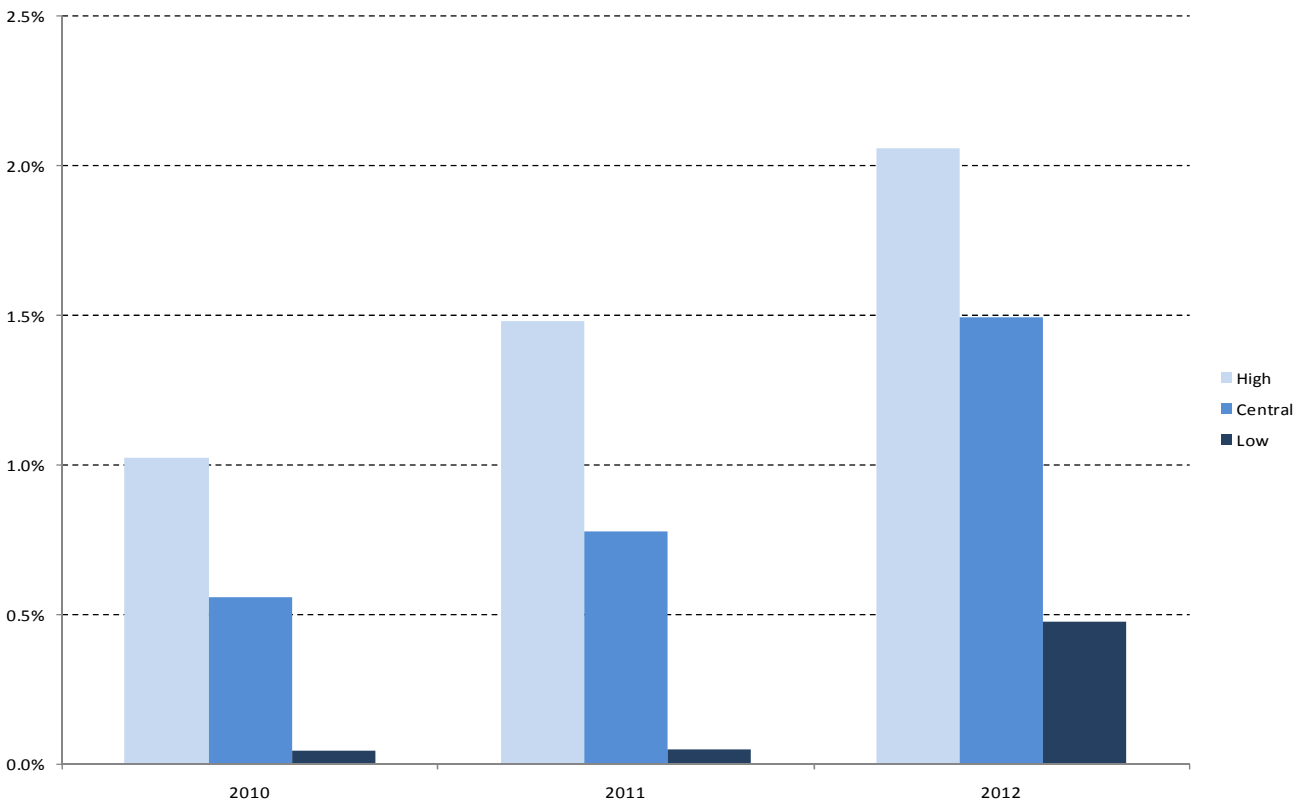


Figure 4: Forecasts of GVA growth in Services, 2010-2012



growth in 2010 ranges from 0.0% to 1.0%, while in 2011 GVA growth is forecast in the range from 0.1% to 1.5%. This range of outcomes for the services sector has been revised slightly upwards from that presented in February's *Forecast*. As previously noted, the recovery in consumer confidence and household spending (both in Scotland and in major, or new, export markets, particularly the rest of the UK) will drive the speed and duration of the recovery across the aggregate Service sector. One key area within the Service sector will be the future performance of Financial Services (which together with Business Services is worth almost 25% of Scottish GVA). We forecast this sector to see a small return to positive growth in 2010, although there continues to be significant job reorganisation across the financial services sector from 2010-2011. We expect that we will see continuing changes in the shape of the financial services

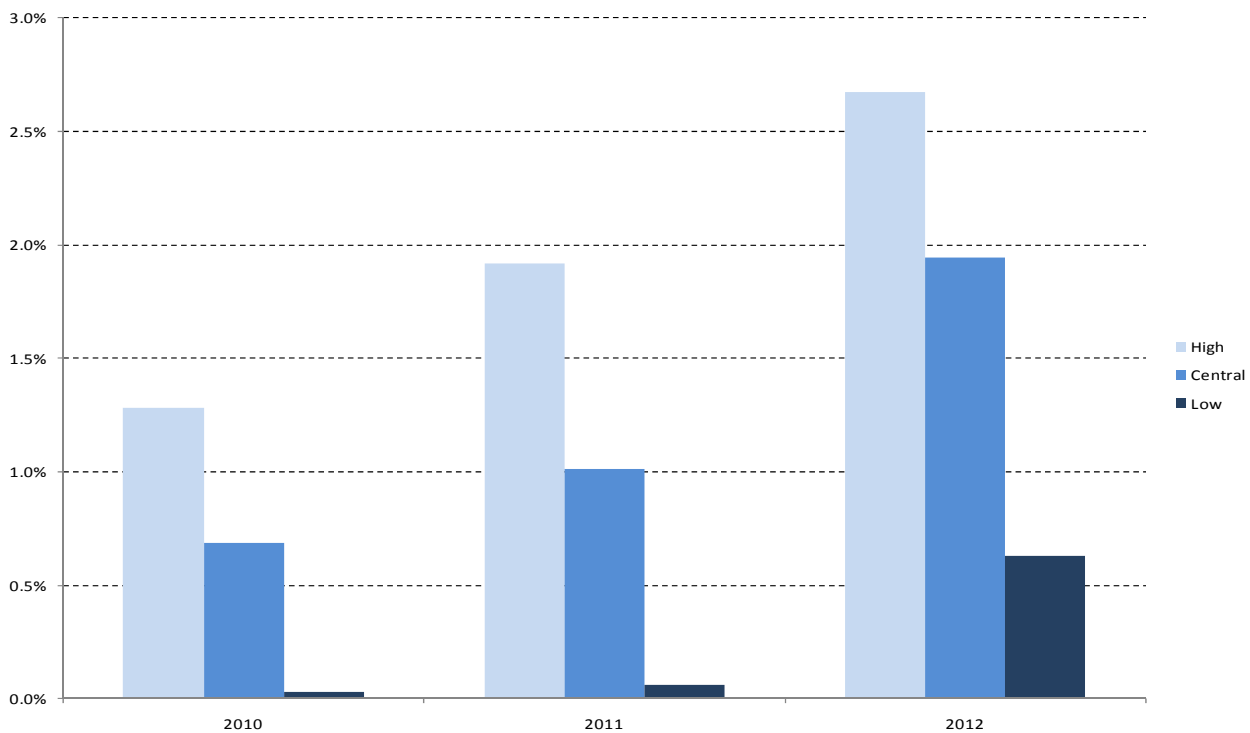
sector well into 2011, and the future shape of the sector will be considerably different than prior to 2008.

Figure 5 estimates that declines in GVA in the Construction sector seen in 2009 do not continue into 2010. Having fallen 10.8% in 2009, we forecast that Construction GVA grows slightly from its current level across all three scenarios. The "Central" scenario sees the sector growing 0.7%, 1.0% and 2.0% over 2010, 2011 and 2012 respectively. Growth this year is driven, in part, by government spending growing in this year. Looking forward however, large declines in public spending are anticipated, but we forecast some increasing demand from private business investment.

Employment

Our forecasts for employment for each of the three

Figure 5: Forecasts of GVA growth in Construction, 2010-2012



scenarios are given in Table 4, along with the net aggregate employment change over the year. As in previous forecasts the employment figures relate to jobs, not FTEs, and are calibrated on the end-year (December) figures from the Employers' Quarterly Survey Series, as given in Table 6.06 of the Economic and Labour Market Review, published by National Statistics. This gave total jobs in Scotland at December 2009 as 2,336,220 (down 48,847 from December 2008). As we have previously forecast, we anticipate in our Central scenario that total job numbers in Scotland will fall in aggregate in 2010, and see a recovery to positive job growth in 2011.

In "Central", the number of jobs is forecast to decline by 33,546 in 2010 (marginally down on the number of jobs forecast to be lost in February's *Forecast*). Total job numbers, and jobs in all of these broad industrial sectors, are forecast to increase in 2011 and 2012. Total jobs in 2012 are forecast to be around 31,000 lower than the jobs total for 2008 (a year when historic highs and lows respectively for the employment rate and unemployment rate were seen in Scotland).

In all scenarios, total job numbers in Scotland are forecast to continue to show a decline in 2010, following that decline

seen through 2009. Table 5 shows the net annual growth in jobs in each of the three scenarios. The speed of the decline is however forecast to be much reduced. In the “Central” scenario, the forecast is for around 33,500 jobs to be lost in Scotland in 2010, down by approximately half from the fall of almost 49,000 jobs in 2009. Our “Low growth” scenario forecasts a fall of 48,000 jobs, approximately mirroring the number of jobs lost in Scotland in the previous year. The number of jobs in Scotland is forecast to increase across the “High growth” and “Central” scenario in 2011. In our “Central scenario” we forecast jobs growth of 14,850 in 2011, with an increase of 35,100 in the “High growth” scenario, and a decline of 6,000 in our “Low growth” scenario.

Looking at the sectoral breakdown for these employment changes, in all scenarios the Services sector sees the largest decline in job numbers in both 2009 and 2010. Overall, the number of service sector jobs are forecast to fall by 30,872 between December 2009 and December 2010. In the “Central scenario” the most significant number of jobs are forecast to be lost in 2010 in Health and Social work (down by 6,770 jobs), with large numbers of jobs forecast to be lost in Wholesale and Retail (down 6,071 jobs) and Real estate and business services (down 5,793).

The Construction sector, which lost 16,861 jobs in 2009 is forecast to lose over 1,700 jobs in 2010, and see a slow growth in job numbers through 2011 and 2012. As with the aggregate jobs total, the total jobs in Construction in 2012 (124,585) is forecast to remain below levels of 2008 (139,100). In the “High growth” scenario, job losses in construction are smaller in 2010, falling by over 1,000 jobs, while the “Low growth” scenario forecasts 2,530 jobs are lost in this sector. It is a typical feature of previous recessions, and in particular the investment-led recession of the credit crunch associated with the 2008-9 recession, that the Construction sector has seen both quicker, and earlier, declines than the rest of the economy. This would suggest that in the upswing phase of the recovery, it would be likely to see increased activity ahead of much of the economy. The sluggishness of a return to growth in the private and public building market may contribute to the growth of employment in Construction in the upswing being less, and

starting later, than that seen in previous recessions in Scotland.

Production jobs were forecast to fall in 2009 by over 12,000 in the Central scenario, and outturn data showed that the number of jobs was indeed 12,282 lower in 2009 than in 2008. We forecast that the number of Production jobs in 2010 will decline only slightly in 2010, down almost 800 jobs. The forecasted job changes in the “High growth” and “Low growth” scenarios are 3,192 and -5,192 jobs respectively. Within the Production sectors in the Central scenario, the largest job growth is forecast in the Mining and quarrying sector (+236 jobs) and Textiles (+373 jobs), while those sectors forecast to see the largest reductions in job numbers are Food and Tobacco (-358 jobs) and Electrical and instrument engineering (-278 jobs).

Unemployment

We present our 2010 to 2012 forecasts for unemployment, as measured by the ILO definition, as well as those claiming unemployment benefit in Table 6. The preferred measure of unemployment is the ILO definition, as given by the Labour Force Survey. This measure is preferred as it reveals the extent of labour which is unemployed and available for work, rather than that portion of the available Scottish labour force which is currently in receipt of unemployment benefit. As such, it is a better measure of the extent to which labour resources are not currently employed in productive activity in Scotland.

Of crucial importance to the realised levels of unemployment will be the extent to which people who lose employment switch into the unemployed, or move into labour inactivity, i.e. are unemployed but not available for work. One potentially important feature of the 2008-9 recession has been the extent to which the inactivity rate in Scotland has increased (up 1.5% points in the last year), and it currently stands at 37.5% for 16+, and 21.7% for working age people.

Table 7 shows the ILO and claimant count measures of unemployment under each of the three scenarios of our forecasts.

Table 7: ILO unemployment rate and claimant count rate measures of unemployment under each of the three forecast scenarios

	2010	2011	2012
ILO unemployment rate			
High growth	8.4%	7.4%	6.2%
Central	8.9%	8.7%	8.1%
Low growth	9.5%	10.1%	10.7%
Claimant count rate			
High growth	5.0%	4.4%	3.9%
Central	5.3%	5.5%	5.1%
Low growth	5.6%	6.0%	6.8%

Modelling the impact of the public spending cuts in Scotland

As discussed above, it is anticipated that years (up to 2014-15) will see a combination of significant reductions in Government spending and increases in taxation. This follows increases in public spending over the last ten years which were themselves larger than seen in the previous decade. Between 2000-1 and 2009-10, Scottish Government figures report that the budget of the Scottish Parliament – funded through the block grant from the Westminster government through the Barnett formula – has risen in real terms by an average of 5.0% a year. The Scottish Government's own estimates from April 2010 predicted a reduction in real terms spending in 2010-11 of around 1% and then three years of an average real terms declines in public spending in Scotland of 2.9%. This would mean that by the year 2014-15, spending under the control of the Scottish Government would be 12.4% lower than in 2009-10, removing £3.7billion from annual public spending in this year.

The future budgets for the Scottish Government – determined as it is through the Barnett formula – will be clearer following the UK Governments Comprehensive Spending Review, scheduled to report on the 22nd of October 2010. Only after this will we know the spending of individual departments (DELs) for the three years, 2011-12, 2012-13, 2013-14, along with the anticipated budget for the Scottish Parliament over these three years. By all scenarios, however, it sees likely that these years will see large declines in public spending in Scotland in real terms. To the extent that the spending reductions across Westminster departments are greater than those anticipated after March's Budget, it is likely therefore that government spending in Scotland in 2014-15 will be approximately 14% lower in 2014 – 2015 than in 2009 – 10 (a greater reduction than the 12.4% anticipated by Chief Economic Advisor in April 2010's "Outlook for Scottish Government Expenditure" publication).

As of the first quarter of 2010 there are 610,200 people employed (headcount figures) in the public sector in Scotland (including public sector financial institutions, or 573,900 excluding these). To the extent that government spending directly employs workers across Scotland it is likely that reducing government spending will impact upon the number of jobs in the public sector over the next five years. Reductions in spending and employment in the public sector will also have impacts across the Scottish economy. This will happen as other industries across Scotland currently rely on the public sector for contracts and as purchasers of goods and services, and so they will be exposed to the reduction in public spending. With lower current spending – reducing the wage costs of the public sector in Scotland – it is difficult to imagine any sector of the Scottish economy being untouched.

We have modelled the impact on the Scottish economy of the reductions in government spending in Scotland. This

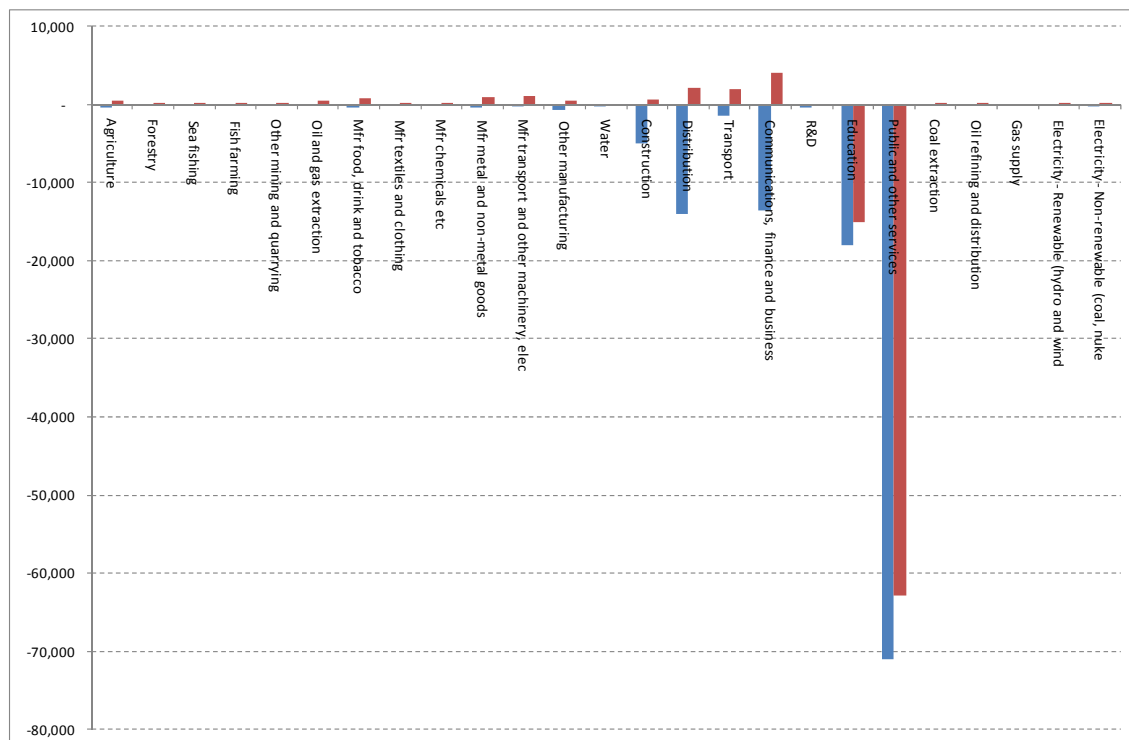
uses a CGE model of the Scottish economy which captures the linkages between industries within Scotland and between purchasers of goods and services, including Government, produced by industries in Scotland. We can use it to demonstrate the impact on the Scottish economy of reductions in government spending in Scotland.

Reducing spending in the public sector by 14% over five years significantly acts to reduce demand across the Scottish economy. Use of the CGE model reveals that the impact of 14% government spending cuts in Scotland would not only reduce employment in the public sector, but also in sectors which are themselves linked to the public sector. Employment in the public sectors is lower by 89,559 with non-public sector employment falling by 36,681. Sectors which are themselves non-public, but which see reductions in employment are Distribution (which includes Retail activities) – which sees employment falling by almost 14,000 – and the Communications, finance and business sector – which sees employment falling by 13,500. The sectoral employment change of this simulation is shown in the first column of Figure 1. In this case, after five years employment across the Scottish economy is 126,240 lower than what it be without the public spending cut.

However, with lower government spending in Scotland, and lower demand for labour, wage costs in Scotland may be lower than they otherwise would be without the spending cut. This would reduce costs to industries in Scotland, and has been argued by some could lead to increased employment in the Scottish economy as firms grow. When we allow for wages to adjust to the levels of economic activity in Scotland, we get the sectoral employment change shown in the second column in Figure 1. Overall, employment is lower by 64,178 than it otherwise would be without the spending cut, and so is reduced from the previous case. Employment falls in the public sectors by 77,942, but increases in the non-public sectors by 13,764.

In conclusion therefore, spending cuts in Scotland of 14% over five years will lead to employment falling in both our scenarios. If wage costs in Scotland are lower than they would be without the public spending reduction, employment in the private sectors is increased – since wages are reduced – but not by sufficient to offset the declines in employment in the public sector.

Table 1 shows the absolute changes in sectoral employment in both scenarios – labelled Fixed price and Flexible price, respectively. Table 2 shows the key economic variables after five periods, and reveals that GDP/GVA in Scotland is 4.2% lower under the Fixed price scenario (i.e. when real wages are fixed and substitution is not possible). The GVA decline is less (-1.6%) under the Flexible price scenario, largely due to real wages being 1.8% lower than they otherwise would be, and partially offsetting the fall in employment through increased competitiveness of Scottish exports.

Figure 1: Sectoral change in employment after five years following 14% reduction in real government spending in Scotland**Table 1: Change in sectoral employment after five periods, absolute differences from base**

	Fixed price	Flexible price
Agriculture	-374	562
Forestry	-14	66
Sea fishing	-4	98
Fish farming	-1	30
Other mining and quarrying	-45	47
Oil and gas extraction	-94	456
Mfr food, drink and tobacco	-408	733
Mfr textiles and clothing	-101	174
Mfr chemicals etc	-108	166
Mfr metal and non-metal goods	-400	927
Mfr transport and other machinery, elec	-181	1,048
Other manufacturing	-702	511
Water	-207	-95
Construction	-5,003	667
Distribution	-13,974	2,168
Transport	-1,390	1,963
Communications, finance and business	-13,514	3,979
R&D	-384	-53
Education	-17,959	-14,977
Public and other services	-71,009	-62,817
Coal extraction	-30	22
Oil refining and distribution	-36	16
Gas supply	-69	-1
Electricity - Renewable (hydro and wind)	-27	14
Electricity - Non-renewable (coal, nuke)	-205	120
Total	-126,240	-64,178

Table 3 shows the percentage changes in sectoral employment and GVA after five periods under the two modelled scenarios. As with the employment level changes shown in Table 1, the sectors which are most dependent on the public spending for their activity suffer the most – with big reductions in output and GVA in the “Education” and

“Public administration” sectors. While the size of these reductions in these two sectors is reduced under the “Flexible price” case, overall – as shown in Tables 1 and 2 – aggregate employment and GVA in Scotland is lower than it otherwise would be but for the reductions in government spending in Scotland.

Table 2: Key economic variable changes after five periods, % difference from base

	Fixed price	Flexible price
GDP	-4.2%	-1.6%
Investment	-2.9%	-0.7%
Real wage	0.00	-1.8%
Exports	0.00	2.1%
Imports	-2.8%	-3.0%

Table 3: Sectoral output and GVA change after five periods, % difference from base

	Sectoral change in output		Sectoral change in GVA	
	Fixed price	Flexible price	Fixed price	Flexible price
Agriculture	-1.1	0.8	-1.1	0.9
Forestry	-0.5	1.8	-0.5	1.8
Sea fishing	-0.1	2.3	-0.1	2.4
Fish farming	-0.1	1.9	-0.1	1.9
Other mining and quarrying	-1.8	1.2	-1.8	1.2
Oil and gas extraction	-0.4	1.3	-0.4	1.3
Mfr food, drink and tobacco	-0.9	1.0	-0.9	1.1
Mfr textiles and clothing	-1.0	1.2	-1.0	1.5
Mfr chemicals etc	-0.9	0.7	-0.9	0.9
Mfr metal and non-metal goods	-0.9	1.5	-0.9	1.8
Mfr transport and other machinery, electronic and electrical engineering	-0.3	0.9	-0.3	1.2
Other manufacturing	-1.9	0.8	-1.9	1.1
Water	-4.9	-2.1	-4.9	-1.8
Construction	-3.5	0.1	-3.5	0.4
Distribution	-2.6	0.1	-2.6	0.2
Transport	-1.6	1.8	-1.6	1.9
Communications, finance and business	-2.8	0.3	-2.8	0.4
R&D	-4.2	-1.0	-4.2	-0.6
Education	-9.1	-7.6	-9.1	-7.4
Public and other services	-10.8	-9.1	-10.8	-8.8
Coal extraction	-2.5	1.4	-2.5	1.7
Oil refining and distribution	-1.9	0.1	-1.9	0.4
Gas supply	-3.4	-0.7	-3.4	-0.2
Electricity - Renewable (hydro and wind)	-2.4	0.5	-2.4	0.5
Electricity - Non-renewable (coal, nuke)	-2.4	0.7	-2.4	0.8

Review of Scottish Business Surveys

Overall

Interpreting business survey trends, especially those relating to the service sector, have been more problematic than normal, given the change to VAT rates at the beginning of 2010, an unduly harsh winter, the ending of the car 'scrappage' scheme, travel and related dislocation due to the Icelandic volcano eruption and rising petrol prices. In contrast almost all surveys (the quarterly Scottish Chambers, Scottish Engineering, Confederation of British Industries and monthly Bank of Scotland PMI surveys) have reported rising confidence, activity and exports in Scottish manufacturing. Data for May 2010 (Bank of Scotland PMI report and Leading Indicators Report) suggests a slight acceleration of the recovery in the private sector with both output and new business growth in both manufacturing and the service sectors. However, retail sales remain weak with like-for-like sales 0.8% lower than in May 2009 and the Scottish Retail Consortium concluded 'customers are nervous about the future... where there was growth....(it) was helped by discounts and better weather'. But consistently all surveys add a note of caution as to their forecast for the second half of 2010.

Data from the Scottish Chambers' Business Survey (SCBS) for the first quarter of 2010 reported that the extreme weather conditions over much of the first quarter has been a significant factor, affecting both business confidence and activity across all sectors. It noted manufacturing trends continue to offer the clearest signs of an emerging, but possibly weaker recovery. Of concern were the uncertainties posed by weak consumer spending, rising transport and energy costs and uncertainties as to Government fiscal and monetary policies and to the extent of cuts in public sector expenditure after the May election. A similar note of uncertainty was reported in the Lloyds TSB Scotland Business Monitor (quarter to end February 2010) which noted 'the tentative recovery from the recession stalling.... It is unclear whether this is a one-off weather induced effect or a more persistent slowdown.' The Bank of Scotland PMI (March) noted the 'rising raw material, fuel and wage costs as drivers of input price inflation, while unfavourable currency fluctuations compounded increases in costs'.

The SCBS (2010:Q1) and Lloyds TSB Scotland (Q to end February) both reported signs of a sustained recovery in the Scottish economy remaining elusive and with more signs of a slowing down in the recovery. However, later surveys (Bank of Scotland Index of leading indicators for May, Scottish Engineering (2010:Q2) were more positive, Scottish Engineering noted 'order intake, output volume, and employee numbers have all returned to positive

territory for the first time in three years (but) plans for capital investment remain negative', whilst the Bank of Scotland Leading Indicators index reported the 'economic recovery in Scotland to continue', but added that the pace of improvement looks set to moderate into the second half of the year.

Oil and Gas

The latest Oil & Gas UK (OGUK) index (2010 Q1) and the Aberdeen & Grampian Chamber of Commerce (AGCC) Oil & Gas Survey Number 12 (covering the period November 2009 – March 2010) reported rising business confidence across the industry, and for a further quarter a net of both exploration & production and supply chain companies reported rising activity levels, although these seemed stronger in the international market than in the UKCS. The Oil & Gas UK index reported more signs of investment levels improving, although overall investment trends remained level in both quarter 4 2009 and quarter 1 2010. The OGUK index (Q1 2010) reported rising employment trends amongst exploration and production companies, but demand remains weaker with level trends in manpower and day rates and in spend on training. The AGCC report was more cautious, reporting a level trend in employment amongst operators, but rising trends amongst contractors, with the overall trends concealing reduced use of temporary and contract staff.

The downward trend in employment was less severe than had been anticipated, although there was clear evidence of reductions in pay rates and less use being made of temporary and contract staff.

UKCS activity continues to be influenced by international events. Oil prices continued to recover from the lows reported at the beginning of 2009 and oil was trading in the range \$70 – 80 bbl by the end of 2009 and with estimates of \$85 – 95 bbl by the end of 2010. Some analysts continue to predict higher prices, and by early April 2010 the first prediction of \$100 bbl by the end of 2010 was reported. Nevertheless, there continues to be considerable variation in the estimates as to the price of oil by the end of 2010 and in the longer-term as market dynamics remain highly volatile. As Cambridge Economic Research Associates note, global supply depends on a number of 'above ground drivers – economics, costs, service sector capability, geopolitics, the timing and nature of government decision making and investment' (2009). Geopolitical uncertainty, changed government decision making and investment decisions continue to stimulate concerns as to international supplies and, as these issues become more or less 'topical' contribute to movements in prices and volatility in the markets.

Production

The latest available Lloyd TSB Scotland Business Monitor (quarter ending February 2010) suggested the tentative recovery from the recession appeared to be stalling.

Table 1: Business Confidence (net trends) Manufacturing, Construction and tourism – Scottish Chambers’ Business Survey

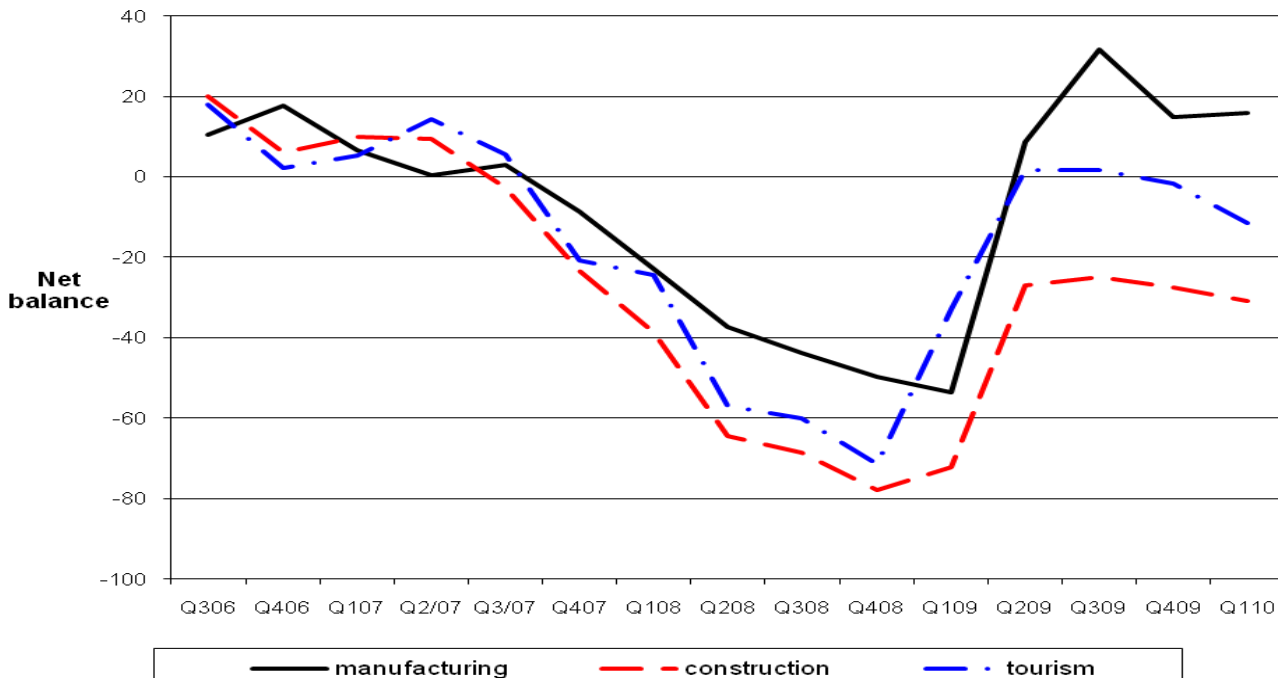
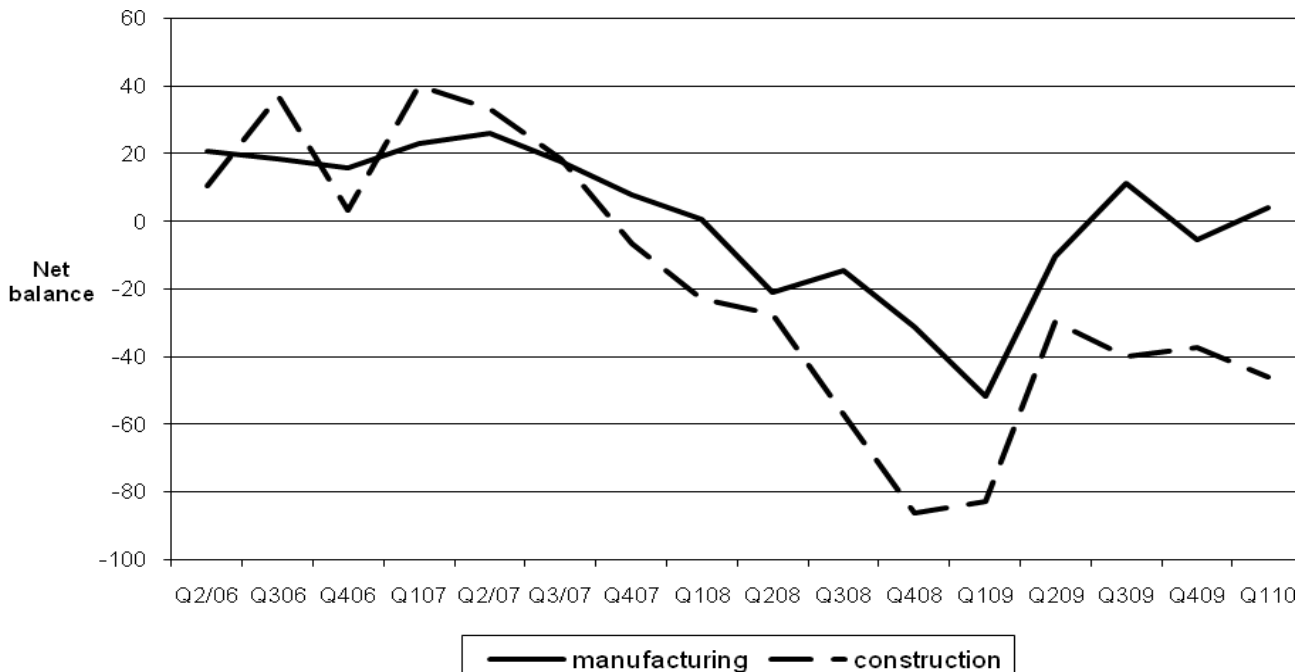


Table 2: Orders and Contracts (net trends) Manufacturing and Construction – Scottish Chambers’ Business Survey



Likewise, the Bank of Scotland PMI for April noted some easing in the rates of expansion, but reported positive growth in manufacturing output and new orders. More recent data from the Bank of Scotland (PMI Scottish private sector activity in May) suggests a speeding up of the recovery in the private sector.

Manufacturing

Optimism

Both the Scottish Chambers and Scottish Engineering reported rising trends in business confidence in the first quarter of 2010, although amongst the Scottish Chamber respondents this was at more modest levels than in q 3 2009. Results for the three months to April (CBI Industrial Trends) indicate a more positive picture, and the second quarter from Scottish Engineering suggest the proportion of respondents being less confident has eased, whilst the same proportion report being more confident, underpinning these trends is an improvement in order intake and output volumes.

Orders and Sales

Once again, for SCBS respondents (2010:Q1), the outturn in total new orders and export orders was weaker than expected. Trends in total orders rose due to improving export trends; however, respondents remain more optimistic as to an improvement in the second quarter. In contrast, Scottish Engineering Survey respondents reported that the trend in orders continued to rise for the third consecutive quarter with the net balance at the highest level since q4 2007. Likewise the May Bank of Scotland PMI reported a solid increase in new manufacturing orders.

Declining trends in output volumes, order intake and the level of work in progress were evident in surveys covering the first quarter of 2010. SCBS respondents reported average capacity used rising marginally by 3.4 percentage points to 75.1%, although 46% (61% in Q4, 57% in Q3 and 71% in Q2) reported capacity used was below preferred levels. Surveys covering the quarter to end April (CBI) and for the second quarter (Scottish Engineering) suggested a strong upturn in orders and output volumes.

Pressures to raise prices due to transport costs and raw material costs were evident across most surveys, the CBI noting 'average unit costs rising at their fastest rate since January 2009' and the Bank of Scotland PMI commenting 'the sharp rise in average input costs during May is of concern, with the pace of inflation again faster than that seen in the wider UK economy'.

Investment

Plans for investment generally remained negative across the main surveys, with investment being mainly limited to replacement (SCBS and CBI) although surveys were divided as to whether this was a reflection of continued uncertainty or as Dr Peter Hughes of Scottish Engineering

suggested that "Despite assurances to the contrary there continues to be very little evidence of banks making money available for our manufacturing engineering sector."

SCBS manufacturing respondents noted cash flow trends remained stable and better than those reported earlier in 2009 and through 2008. Respondents are again more confident as to rising turnover over 2010, and the net trends are the most positive for nine quarters, but again expectations as to rising profitability eased.

Employment

SCBS firms reported that recruitment was at a lower level than in Q4 with only 26% attempting to recruit mainly to replace staffs – as overall employment levels, although not hours worked, eased. Scottish Engineering firms reported that staffing numbers continued to rise, most notably for small and larger companies but rises were less evident for medium sized firms. Both the April and May PMI reports noted a rise in manufacturing employment as higher workloads increased workforce requirements.

Construction

Optimism

Data from the Scottish Chambers' Business survey and Scottish Construction Monitor (2010:Q1) suggests business confidence remains weak with only 8% reporting being more confident compared to a year ago.

Contracts

SCBS respondents reported that the net trend in new contracts remained very weak, but the rate of decline was almost half that of a year ago. The trends in orders from all sectors continued to decline although the rate of decline in private commercial and domestic/house building orders is significantly less than a year ago. Nevertheless, expectations as to turnover trends over the next year remain depressed and show few signs of improvement. For a further quarter a net of -48% anticipate declining turnover trends. A net of -64% (-60%, -44%, -59% and -78% in the previous four quarters) anticipate declining profitability over the next twelve months. A net of 75% of construction firms anticipate declining tender margins over the next twelve months.

Average capacity declined by one percentage point to 66%, four percentage points lower than a year ago. However, whilst the actual and expected trends in work in progress remain weak they are less depressed than a year ago.

Employment

Almost half of SCBS firms reported reduced total employment levels and no respondent reported an increase in employment, and recruitment again remained at very low levels. Only 8% of respondents reported increasing pay in the first quarter by an average of 4%. The Scottish Building Federation estimates that more than 30,000 jobs have been

lost since 2008 and with further job losses anticipated in 2010, as almost a quarter of their respondents expect to reduce employment in 2010. More seriously the SBF estimate that the number of apprentices in training in 2010 could decline by over 50%.

The service sector

Lloyds TSB Business Monitor reported that the service sector firms experienced a worsening in trading conditions in the three months to the end of February 2010. In common with other service sector surveys the Bank of Scotland PMI for April reported that activity in the service sector had been impacted by the volcanic ash cloud that caused severe disruption to transport. However, the May Bank of Scotland PMI reported an increase in new business in the sector and the service sector 'returning to growth after a two month period of decline'.

Retail distribution

Optimism

SCBS retail respondents reported low levels of business confidence at the end of the first quarter, and noted the effects of adverse weather conditions on business activity. Confidence has remained low amongst consumers in 2010 and has, according to the Scottish Retail Sales Monitor, contributed to reduced sales.

Sales

The Scottish Retail Sales Monitor has noted a series of impacts on sales, in its latest report (published June 16th) it noted 'May's results give us a clear indication of the underlying weakness of Scottish sales growth. It's back in line with the poor performance seen in the first two months of the year.....customers are nervous about the future and generally reluctant to spend when they don't have to'.

More than half of retailers in the SCBS reported and expect declining sales in the first and second quarters and almost three quarters of retail respondents expect price increases during Q2 2010. The Scottish Retail Sales Monitor noted like-for-like sales were 0.8% lower than in May 2009 and the three month weighted average to end May shows like-for-like sales dropping by 0.6%.

Employment

Most SCBS firms reported and expect no change to overall employment levels in the three months to June, although the results suggest continued reductions in employment in the sector. In common with other sectors recruitment levels remain at historically low levels.

Tourism

Optimism

Business confidence in the sector remained weak according to hotels responding to the SCBS 2010:Q1 survey, although

confidence was significantly less depressed than in the first quarters of 2009 and 2008.

Demand

Underpinning trends in the tourism sector is the weakness in demand, although the Scottish Hotel Occupancy study noted the average bed and room occupancy figures for both February and March were little changed from previous years. There is a broad similarity in the room/bed occupancy rates recorded by the Scottish Hotel Occupancy Survey for February and the SCBS results for the first quarter, but the SCBS survey indicates weakness in terms of restaurant and conference facilities. The latest data (April occupancy) suggests demand is slightly lower than in 2009, with average room occupancy at the lower end of the range in the period 2006 – 2010.

Hotels continued to reduce room rates and the discounting of prices is more marked than during the same quarter a year ago and is set to continue, though ease, in the three months to the end of June.

Business constraints

An overall lack of demand remained the primary business constraint for more than four fifths of SCBS hotel respondents, although there were also concerns with competition and exchange rates. A third of hotels felt that their area had suffered due to poor marketing.

Employment

Changes in employment levels were reported by around half of SCBS firms. Net declining trends in full time (-15%), part time (-32%), seasonal (-49%) and overtime working (-50%) were reported.

Outlook

A clearer return to growth later in the year was forecast in the February Lloyds TSB business Monitor, whilst the Scottish Chambers' Business Survey for the first quarter noted 'for a further quarter manufacturing trends continue to offer the clearest signs of an emerging, but possibly weaker recovery'. For all other sectors the impact of the harsh winter has clearly affected results. The trends for 2010 remain uncertain; any recovery will have to contend with weak consumer spending, rising transport and energy costs and uncertainties as to Government fiscal and monetary policies after the May election.' A slightly more positive image was reported by the CBI in the quarter to end April. It noted rising output and expected this would continue, but added 'uncertainty about demand is still the factor most likely to limit capital spending in the next twelve months, with concerns greater than in the previous three quarters'. Scottish Engineering in its review of the second quarter forecast positive trends in both domestic and export orders, although domestic demand being possibly at more modest rates than in the first quarter. The Bank of Scotland PMI for May was the most positive, indicating that 'Scottish private sector activity growth gained momentum', with the fastest

output growth in three months and stronger job creation. The Bank of Scotland index of Leading Indicators (produced by Markit) was likewise more positive anticipating a recovery in GDP in the coming quarters, although, in common with other surveys it noted 'the pace of improvement in looks set to moderate into the second half of the year'.

Cliff Lockyer/Eleanor Malloy
June 2010

Current trends in Scottish Business are regularly reported by a number of business surveys. This report draws on:

1. Aberdeen & Grampian Chamber of Commerce Oil and Gas Survey No 12 (November 2009 – March 2010)
2. The Confederation of British Industries Scottish Industrial Trends Survey for the first quarter 2010;
3. Lloyds TSB Business Monitor 49 for the quarters December 2009 to February 2010 and expectations to August 2010;
4. Scottish Engineering's Quarterly Reviews for the first and second quarters of 2010;
5. The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Index for March, April and May 2010;
6. The Bank of Scotland Index of Leading Indicators (May 2010)
7. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor for March, April and May 2010;
8. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the first quarter of 2010;
9. Oil & Gas UK quarterly Index quarter 1 2010;
10. Visit Scotland Occupancy Survey March and April 2010;
11. The Scottish Construction Monitor quarter 1 2010.

Overview of the labour market

Current interest in the Scottish labour market continues to focus on the trends and patterns in the unemployment figures and again in this issue we note recent changes in Scottish labour market trends, with the usual caution of recognising the differences between the figures for employment and jobs and the impact of the trends in the numbers economically active and inactive on unemployment rates. The increasing concern as to the likely future trends in employment in the public sector prompts a consideration of the numbers and trends in public sector employment in Scotland.

Recent trends and statistics

Comparable figures on the labour market¹ between Scotland and the United Kingdom in the quarter February – April 2010 are summarised in Table 1. Labour Force Survey (LFS) data show that in the quarter to April 2010 the level of employment in Scotland fell by 47 thousand, to 2,432 thousand. Over the year to April 2010, employment in Scotland fell by 83 thousand. For the same period, UK employment fell by 213 thousand. The Scottish employment rate – those in employment as a percentage of the working age population – was 71.8 per cent, down 2.8 per cent compared to one year earlier. For the same period the UK employment rate was 72.1 per cent, down 1.2 per cent compared to one year earlier.

In considering employment, activity and unemployment rates it is important to remember the bases and relationships of these figures. LFS data is provided for: (1) all aged 16 and over and (2) for all aged 59/64. The first measure (all aged 16 and over) leads to higher numbers in employment, in the total economically active and economically inactive – but reduces the economic activity rates and unemployment rates, but at the same time increases the economically inactive rate. Conversely, the second measure (all aged 16 to 59/64) leads to lower numbers economically active, in employment and economically inactive – but leads to higher economically active, employment and unemployment rates but lower economically inactive rates.

The relationships between employment, unemployment, totally economically active and inactive are important in appreciating changing levels of employment and unemployment, and changes in the employment rates should be seen in conjunction with changes in the activity rates. If people leave employment and become unemployed (but are still economically active) the unemployment rate increases, but the economically active

rate remains unchanged. However, if people leave employment and do not seek employment, as seems to be an emerging pattern, they are categorised as economically inactive, as such the unemployment rate remains unchanged whilst the activity and inactivity rates change. This is clearly shown in table 1. Over the year to April 2010, the numbers employed fell by 83 thousand, but unemployment only rose by 35 thousand. However, the numbers of those aged 16-59/64 who are economically inactive rose by 54 thousand and the numbers economically active fell by 48 thousand.

Table 1 shows that for Scotland the preferred International Labour Organisation (ILO) measure of unemployment rose significantly to 212 thousand, between February–April 2010, or by 35 thousand over the year². The ILO unemployment rate rose in the three months to April 2010 and now stands at 8.0 per cent. This represents a 0.4 per cent rise over the last quarter and a 1.4 per cent rise relative to the same period a year earlier. The comparable ILO unemployment rate for the UK stands at 7.9 per cent, and is up 0.1 per cent over the most recent quarter and up 0.6 per cent over the year.

The economically active workforce includes those individuals actively seeking employment and those currently in employment (i.e. self-employed, government employed, unpaid family workers and those on training programmes). Table 1 shows that the level of the economically active rose by 1.1 per cent between February-April 2010. There were 2,644 thousand economically active people in Scotland during February–April 2010. This comprised 2,432 thousand in employment and 212 thousand ILO unemployed. The level for those of working age but economically inactive rose in the last quarter, up 1.1 per cent on the previous quarter to 699 thousand people; an increase of 1.6 per cent in the number of people of working age economically inactive over the last year.

In the year to September 2009 (the latest available data) inactivity rose by 10.4% (to 51,000) for men aged 18-24 and by 8.3% (to 25,000) for men aged 25–34. The comparable figures for women were -2.1% (68,000) and -1.9% (66,000).

The most recent (seasonally adjusted) figure for Jobseekers allowance claimants in Scotland stood at 135.5 thousand (or 134,800 computerised claims in May 2010). The UK claimant count rate at May 2010 was 4.6 per cent, down 0.1 per cent over the year.

Unemployment data at the Scottish constituency level for May 2010 is available in a SPICe Briefing, with the next update available 14th July 2010.

The most recent figures for the number of employee jobs by industrial activity are detailed in Table 2. Employee job figures are a measure of jobs rather than people. Total

Table 1: Headline indicators of Scottish and UK labour market, February – April 2010

February – April 2010		Scotland	Change on quarter	Change on year	United Kingdom	Change on quarter	Change on year
Employment*	Level (000s)	2,432	-47	-83	28,855	5	-213
	Rate (%)	71.8	-1.3	-2.8	72.1	-0.1	-1.2
Unemployment**	Level (000s)	212	7	35	2,472	23	192
	Rate (%)	8.0	0.4	1.4	7.9	0.1	0.6
Activity*	Level (000s)	2,644	-40	-48	31,337	28	-21
	Rate (%)	78.3	-1.1	-1.6	78.5	-0.1	-0.7
Inactivity***	Level (000s)	699	34	54	8,186	29	298
	Rate (%)	21.7	1.1	1.6	21.5	0.1	0.7

Source: Labour Market Statistics (First Release), Scotland and UK, June 2010

* Levels are for those aged 16+, while rates are for those of working age (16-59/64)

** Levels and rates are for those aged 16+, rates are proportion of economically active.

*** Levels and rates for those of working age (16-59/64)

Table 2: Employee jobs* by industry, Scotland, December 2009

SIC 2003 Section	All jobs (seasonally adjusted)	All jobs	Agriculture, Forestry and Fishing	Mining Energy and Water Supplies Industries	Manufacturing Industries	Construction	Distribution etc, transport and business services	Education, health, public admin and other services
		A-O	A,B	C,E	D	F	H-K	L-O
Sep 05	2,373	2,373	32	37	232	129	1,102	842
Mar 06	2,376	2,368	31	36	224	135	1,094	848
Sep 06	2,361	2,360	33	38	224	138	1,085	841
Mar 07	2,380	2,371	34	41	222	145	1,082	847
Sep 07	2,389	2,389	33	43	222	139	1,108	844
Dec 07	2,391	2,400	25	42	220	139	1,127	847
Mar 08	2,392	2,382	28	42	218	137	1,109	849
Jun 08	2,396	2,396	35	42	216	136	1,114	853
Sep 08	2,389	2,387	35	41	216	138	1,104	852
Dec 08	2,374	2,385	33	41	212	140	1,103	856
Mar 09	2,362	2,354	37	40	206	139	1,075	858
Jun 09	2,340	2,339	29	41	203	130	1,075	861
Sep 09	2,335	2,332	27	40	203	127	1,071	865
Dec 09	2,322	2,336	29	40	202	123	1,074	868
Change on year	-52	-49	-4	-1	-11	-17	-29	12
Change %	-2.2	-2.0	-11.0	-2.1	-5.1	-12.0	-2.6	1.4

Source: Labour Market Statistics (First Release), Scotland, June 2010

* Employee jobs are a measure of jobs not people. If a person holds two jobs each job will be counted in this table

Table 3: Claimant count by age and duration (computerised claims only) Numbers and percentage change over year to May 2010

	All computerised claims	Up to 6 months	Over 6 and up to 12 months	All over 12 months
All 18+ numbers	134,800	84,400	29,500	20,900
All 18+ % change over year	6.4	-8.7	23.7	102.2
All 18–24 over year	39,100	29,700	7,500	2,000
All 25-49 over year	77,200	46,100	17,100	14,000
All 50 and above over year	21,300	12,100	4,600	4,700

seasonally adjusted employee jobs for the quarter ending December 2009 (the latest available figures) stood at 2,322 thousand. The number of jobs in the manufacturing industry has levelled out at 202 thousand, and down 11 thousand against the same quarter one year earlier. The number of jobs in the service industry fell by 29,000 over the last quarter to 1,074 thousand.

Table 3 provides some limited indications of the experience of unemployment in terms of claimant count by age and duration. The latest figures suggest that 20,700 have been claiming benefit for more than a year, up 10,900 over the year (up 112.1% on the year), 7,500 18–24 year olds have now been claiming benefit for over 6 months and up to 12 months (up 51% over the year).

Public sector employment in Scotland

The increasing recognition of the likelihood of widespread job losses in the public sector prompts a consideration of the trends in public sector employment. There has been much evidence to suggest that most Scottish public sector organisations have been planning considerable budget reductions in recent months, given that staff costs account for around 52% or £18.8 billion of Scottish public spending (Audit Scotland). Audit Scotland noted 'the Scottish public sector is facing the biggest squeeze on budgets since devolution' (2009:8) Announcements prior to the emergency budget included: some 4,000 job losses over the year in the NHS; Scottish universities preparing for up to 15% cuts in public funding over the next four years; likely staff cuts on top of current efficiency savings in Scottish police forces; a BBC survey earlier this month (June) noted that 10 out of the current 32 councils had indicated some 10,000 job losses over the next three to five years. These figures suggest staffing cuts/cuts in staff budgets ranging from 8–15%. The previous Labour administration had planned for 20 per cent real cuts over the next four years. However, the June emergency budget suggests an additional 4.6% with departments, outside health and overseas aid, facing real cuts of 25 per cent over the next four years. The increase of VAT to 20 per cent will impose additional costs on all

departments, including health. Given that the outsourcing of government services has increased in recent years the extent of the proposed cuts implies significant reductions in the numbers of private sector employees servicing public sector services.

Plans include early retirement schemes, but these are not without their problems. Glasgow's plan for early retirement for all staff 50 and over is quoted as leading to problems in the provision of specialist services (e.g. social work, libraries and bereavement services).

Table 4, drawing on Q1 2010 data, indicates 573,900 (23.6% of the headcount numbers employed in Scotland) employed in the Scottish public sector (excluding those employed by RBS and Lloyds who have been reclassified as UK wide public corporations), and table 5 outlines headcount employment at the local authority level.

One of the arguments in support of restructuring public sector services has focussed on the benefits of greater efficiency and cost savings accruing from contracting out public sector services. Evidence from previous periods of contracting out suggests that such benefits may not be easily realised.

The 1998 Workplace Employee Relations Survey, the largest survey of its kind and sponsored by the DTI, ESRC, ACAS, PSI, noted overall '42 per cent of workplaces said they had made cost savings through contracting out, but 31 per cent were now paying more for the same services....government initiatives to stimulate contracting out appear to have led to net savings – 42 per cent of these workplaces were paying less (but) 18 per cent paying more' (1999:36).

Others have called for a policy of incentivisation of public sector staff. Evidence from the Chartered Institute of Personnel and Development would suggest a degree of caution in the adoption of such employment policies. 'PRP has proved in some circumstances a rather crude

Table 4: Total public sector employment in Scotland (headcount) quarter 1 2010

Broad category	Area		
Civil Service	Scottish Govt Depts.	5700	
	Crown Office	1900	
	Scottish Govt Agencies	8300	
	Non ministerial Depts.	1800	
Total Civil Service			17600
Local Government	Teachers	62700	
	Other education	51600	
	Social work	54700	
	Police & Related services	24900	
	Fire & related services	5800	
	Other	104700	
Total Local Government			304300
NHS		163000	163000
Public Corporations		4600	4600
Other public bodies		16100	16100
Total devolved sector	506000		
Armed forces		12100	12100
Civil Service	Min of Defence	5900	
	HM Revenue & Customs	10000	
	DWP	12200	
	Dept for International Dev.	500	
	Scotland Office	70	
	Other Civil service	3900	
Civil service			32600
Public corporations		17600	17600
Public bodies		5800	5800
Public sector financial		36300	36300
Total reserved sector	104300		
Total Scottish employment		610,200	

Source: Quarterly Public Sector Employment series, Scottish Government

Note: Figures may not total due to rounding

instrument and the 1990s and beyond witnessed a number of challenges to the theory. As some of the earlier schemes failed to deliver the promised results, some employers brought in new or revised PRP schemes or moved to new approaches altogether (for example, skills-based pay) while others have developed hybrid schemes. Today, the notion of linking pay to a wider definition of employees' 'contribution' rather than simple 'performance' is gaining ground. This emphasizes not only performance in the sense of the output (the end result that is achieved) but also the input (what the employee has contributed in a more holistic sense).' (CIPD Performance Related Pay Fact Sheet, May 2010).

Additionally the CIPD argued, 'despite considerable interest in linking pay to performance in the public sector dating back many years, this has proved harder to translate into practice..... A number of distinct issues arise when introducing PRP into a public sector setting, including the potential difficulty of measuring individual effort in certain roles. Moreover, public sector workers such as nurses are arguably motivated by a public service ethos which could actually be undermined by some forms of PRP. One theory though is that PRP in a public service setting can help employees to work more effectively rather than to work harder, by encouraging employees to focus on key objectives.' (CIPD Performance Related Pay Fact Sheet, May 2010).

The introduction of a two year public sector pay freeze, apart from those earning less than £21,000, will have to confront a pay landscape in which the rates of pay/reward are more visible and the gap between the lowest and highest paid has increased. All the ratios for earnings and equivalent net income represent high levels of inequality by comparison with those in the UK a generation ago, and by comparison with other industrialised countries. The Report of the National Equality Panel: An anatomy of economic inequality in the UK (published in January 2010) noted: "A recent assessment of the overall impact of tax and benefit reforms since 1979 finds that policy over the 1979 to 1997 period was equivalent to increasing benefits in line with price inflation, while policy since then has been equivalent to increasing benefits in line with the growth of national income. Reforms since 1997 have tended to reduce income inequality, while those of the earlier period tended to increase it" (National Equality Panel 2010:62). Developing a pay policy of restraint, or increased employee contribution for pensions, or a pay cut will need to be seen to be fair, the extent of the problem can be shown in evidence from the recent Pay Review Body on Senior Salaries (table 6), which notes that in the UK over 25,000 people working in the public sector earn more than £100,000.

An indication of total earnings for lead executives is produced by Incomes Data Services (2009). This suggested the distribution of total earnings of lead executives in selected National/Regional public bodies ranged from £72,000 to £262,500 with a median of £157,000. The

comparable figures for non ministerial government departments indicated a range from £82,500 to £272,500 with a median of £187,500; and for public corporations a range from £130,000 to £679,800 with a median of £314,800.

In three respects the announcement of a pay freeze for public sector employees represents a significant reduction in earnings for public sector employees over the next few years: Earnings will fall in real terms as a consequence of inflation; Inevitably local authorities and public sector departments will seek to reduce labour costs by reductions in hours and overtime working (see action by employees in Glasgow museums and sports facilities). There is much to suggest that such reduction will disproportionately affect the lowest paid, part time staff and those on flexible contracts; The employee pension contributions in the public sector will rise.

Outlook

In the year April 2010 the total in employment fell by 83,000 and unemployment rose by 35,000 to 212,000 but the numbers economically inactive rose by 54,000. The pattern of employment continues to change with rising numbers of part time (up 13,000 in the year to September 2009) and temporary employees (up 7,000 over the same period) and declining numbers of full-time workers (down 63,000 in the year to September 2009). Over the same period the numbers of part time workers who could not find a full time job rose by 19,000 (31.6%).

In 1980 unemployment totalled 202,000 (with an ILO unemployment rate of 7%). Unemployment rose through the 1980s to 351,000 in 1986 and the unemployment rate (ILO definition) peaked at 13.7% in 1986. By 1988 unemployment fell below 300,000, reaching 212,000 in 1997 but only fell below 200,000 in 1998. Between 1998 and 2008 unemployment fell by 72,000 to 113,000 (an ILO rate of 4.2%). Since April 2008 unemployment has risen by 97,000 and the unemployment rate has increased to 8.0%. The history of the recessions since the 1980s indicates the extent to which employment growth lags behind economic growth, there are few reasons why we should expect a more rapid job recovery over the next few years. The last twenty years not only witnessed a reduction in unemployment but also an increase in the employment rate (16-59/64) from 70.8% in 1990 to 77.1% in 2007. It is questionable whether this rate will be sustained given the combination of rising unemployment and likely reductions in the range and depth of public sector job support agencies.

The budget and post budget announcements have outlined an online event inviting public sector workers to submit their suggestions for reducing spending. This 'Spending Challenge' is designed to get the best ideas from people who work on the frontline of public services on how we can

Table 5: Local Government employment by staffing group and local authority (headcount) Q1 2010 (not seasonally adjusted)

Local Authority/Joint Board	Education Teachers	Other Education Staff	Social Work	Police and Related Services	Fire Services	Other Staff	Total All Staff
Aberdeen City	2,100	1,700	1,600	0	0	4,100	9,500
Aberdeenshire	3,500	3,300	2,500	0	0	5,600	15,000
Angus	1,400	900	1,600	0	0	1,800	5,700
Argyll & Bute	1,100	1,100	1,100	0	0	2,000	5,300
Clackmannanshire	600	700	400	0	0	1,100	2,800
Dumfries & Galloway	1,900	1,700	1,200	0	0	3,400	8,300
Dundee City	1,800	1,300	1,700	0	0	3,400	8,200
East Ayrshire	1,500	900	1,300	0	0	2,900	6,700
East Dunbartonshire	1,400	900	700	0	0	2,100	5,000
East Lothian	1,200	1,000	900	0	0	1,800	4,900
East Renfrewshire	1,400	900	700	0	0	1,700	4,700
Edinburgh, City of	4,000	3,600	4,400	0	0	7,000	19,100
Eilean Siar	400	500	700	0	0	900	2,600
Falkirk	1,900	1,400	1,500	0	0	3,200	8,000
Fife	4,600	3,800	4,400	0	0	10,500	23,200
Glasgow City	5,400	6,800	5,100	0	0	6,100	23,500
Highland	3,100	2,800	2,400	0	0	4,600	12,900
Inverclyde	1,100	800	1,200	0	0	1,500	4,700
Midlothian	1,100	1,000	800	0	0	1,900	4,800
Moray	1,200	1,100	800	0	0	2,000	5,100
North Ayrshire	1,700	1,200	1,500	0	0	2,800	7,200
North Lanarkshire	4,300	3,200	3,600	0	0	6,700	17,700
Orkney Islands	400	500	800	0	0	1,200	2,800
Perth & Kinross	1,800	1,100	1,400	0	0	1,800	6,200
Renfrewshire	1,900	1,400	1,900	0	0	3,400	8,600
Scottish Borders	1,400	800	1,200	0	0	2,300	5,700
Shetland Islands	600	700	1,400	0	0	1,400	4,100
South Ayrshire	1,400	700	1,100	0	0	2,300	5,500
South Lanarkshire	3,400	2,500	3,000	0	0	6,600	15,500
Stirling	1,200	900	700	0	0	1,700	4,500
West Dunbartonshire	1,500	1,000	1,600	0	0	2,500	6,700
West Lothian	2,200	1,700	1,400	0	0	3,200	8,500
Total Bridge Joint Boards	0	0	0	0	0	100	100
Total Fire Joint Boards	0	0	0	0	5,800	0	5,800
Total Police Joint Boards	0	0	0	24,900	0	0	24,900
Total Valuation Joint Boards	0	0	0	0	0	600	600
SCOTLAND	62,700	51,600	54,700	24,900	5,800	104,700	304,300

Source: Joint Staffing Watch Survey, Scottish Government

Notes:

1. Figures are rounded to the nearest hundred
2. Totals may not add to the sum of the parts due to rounding
3. Figures for Fire Service staff exclude volunteer and retained firefighters
4. Police and Fire Service staff in Dumfries and Galloway and Fife, who are not covered by Joint Boards are included within the figures for Joint Boards for consistency.

Table 6: Estimated percentage of full time employees in selected earnings bands in 2008/9 (UK)

Annual gross pay (£)	Public sector %	Private sector %
Up to 50,000	91.7	87.8
50,001 – 75,000	5.9	7.4
75,001 – 100,000	1.2	2.4
100,001 – 150,000	0.9*	1.4*
Over 150,000	0.2*	1.0*

Source: OME analysis of the ASHE dataset provided by the ONS

* Small sample sizes, figures should be treated with caution.

deliver more for less' (http://www.hm-treasury.gov.uk/spend_index.htm). It is unlikely that a 'workforce demoralised by redundancies, pay restraint and pension reform' (J. Philpott, chief economic adviser to the Chartered Institute of Personnel and Development, 23.6.2010) will want to help the Government deliver its manifesto commitments.

Cliff Lockyer
June 2010

taken mainly from Labour Market Statistics, May 2008 and are consistent with the updated LFS data available on NOMIS from summer 2004. Labour Market Statistics continue to report data for Scotland at the quarterly level, so this will continue to form the basis of our analysis of movements in the labour market between quarters.

²The Labour Force Survey definition of ILO unemployment takes precedence over the claimant count measure. ILO unemployment is much less sensitive to changes in the regulations governing unemployment benefit, and conforms to a widely accepted standard to allow for more meaningful cross-country comparisons.

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Endnotes:

¹The Census 2001-consistent population figures at local authority level were released in February 2003. This has allowed the production of interim regional LFS estimates. The population data only cover the periods up to mid-2001. The data presented here are

Economic perspectives

A review of the constraints, limitations and success of Homecoming Scotland 2009

Alison Morrison* and Brian Hay**

'Whether you are Scottish or simply love Scotland, you are invited to come home – home to the land of your ancestors so you can experience a living culture'

Minister for Enterprise, Energy and Tourism (Scottish Government, 2007a)

Introduction

The aim of this review is to provide insight and analysis of a government tourism initiative within the geographic context of Scotland. It highlights the centrality of public-private partnership and the catalytic role of key government agencies in channelling investment, energies, events and marketing effort for a nationally focused tourism theme of Homecoming Scotland 2009 (HS09). The review also delves below the public relations veneer of many such activities to uncover the political debates and controversies, and the wider issues that may have detracted from the degree of success achieved by the initiative. Given that, the initiative was concluded only within the last few months and has still to be fully evaluated; it is only possible to draw tentative conclusions on the projects outcomes for tourism destination marketing and management in general. The longer-term impacts of HS09 such as repeat visitation and changes in the perception of Scotland will take a number of years to monitor, and only then will we be able to assess the legacy benefits of HS09.

Background

The devolved Government for Scotland is responsible for most of the day-to-day concerns of the people of Scotland, including health, education, justice, rural affairs, transport and economic development, including tourism. As part of a wider political process for the devolved administration for the constituent parts of the UK, the Scottish Government (then called the Scottish Executive) was formed in 1999. For its first eight years, the Scottish Labour Party led the

Opinions expressed in economic perspectives are those of the authors and not necessarily those of the Fraser of Allander Institute

Table 1: Volume and value of tourism in Scotland

	UK Trips (mills)	Overseas Trips (mills)	Total Trips (mills)	UK Spend (£ mills)	Overseas Spend (£ mills)	Total Spend (£ mills)
2007	13.12	2.79	15.91	2,836	1,367	4,203
2008	12.15	2.48	14.63	2,812	1,235	4,047
2009	12.47	2.56	15.03	2,736	1,359	4,095

Source: VisitScotland. Notes: Spend in cash prices, 2009 overseas data provisional

Scottish Government, but in 2007, the Scottish National Party (SNP) was voted into power for the first time, as they held the largest number of seats, although they did not have an overall majority. The lack of a clear majority placed a constraint on their actions and encouraged a degree of cross-party collaboration. One of the SNP's early announcements in 2007 was its support for a tourism destination marketing initiative called Homecoming Scotland 2009, an idea that was first formed under the previous Labour administration and its origins can be traced back to April 2003 (Anon, 2003). Although HS09 was a Scottish Government initiative, its day-to-day management was devolved to EventScotland, the national events agency, working in partnership with VisitScotland the country's national tourism agency. Since its formulation in 2003, Event Scotland has always been located in the same building as VisitScotland and shared a number of common services and staff, and in April 2007 it became a directorate within VisitScotland.

The HS09 initiative was financed by funds from a consortium of organisations including the European Union (through the European Regional Development Fund) and the Scottish Government. VisitScotland and VisitBritain also provided additional support through their generic marketing campaigns. As well as marketing activities, HS09 also distributed grants of between £5,000 and £50,000 either to provide support to existing events or to encourage new events designed to attract visitors of Scottish birth, descent or affinity to Scotland. The grants were administered through EventScotland, and were designed to attract partners to the initiative, and to build on existing work and relationships. The aim was to help private, community and public organisations to stage events to support and mobilise a year-long celebration of Scotland's culture and heritage.

VisitScotland has a strategic role as the public sector agency in providing leadership and direction for the development of Scottish tourism in order to achieve its maximum economic benefit. In total, tourism contributed almost £4.1bn to the Scottish economy in 2009 (4.4% of Scottish GVA in 2007), compared to approximately £4.2bn in 2007, and over 15.0 million tourists took overnight trips to Scotland in 2009, a decline of 5% from 2007. Tourism related employment accounts for around 219,000 jobs, many of which are part-time and seasonal, working in some 20,000 businesses (16,000 VAT/PAYE registered

businesses, of which 94% are Scottish owned), supporting around 9% of employment in Scotland (13% in the Highlands). The sector is dominated by SMEs, with 99% of businesses employing fewer than 250 staff. (VisitScotland, 2009a; Scottish Government, 2009a).

As with many destinations, tourism is critical to the future economic growth of Scotland. Therefore VisitScotland works with the tourism industry and other partners (such as, Scottish Enterprise, Highlands & Island Enterprise and the Scottish Tourism Forum) to achieve an ambitious target of 50% growth in tourism revenues for Scotland by 2015, from the base year of 2005 (Scottish Executive 2006). This growth target is increasingly unlikely to be achieved, but nevertheless it has acted as a useful ambition to drive the growth of tourism in Scotland, HS09 represents an important initiative within this context, as is reflected in the following:

'By trading on 'affinity' for Scotland felt by diaspora whose forebears sailed for foreign lands, whether from steely ambition or cleared from their homes by despotic landowners, the year long celebration of Scottishness underlines the importance of international tourism to the economy.' (Anon, 2009)

This affinity to Scotland by people living overseas was recently highlighted in a review for the Scottish Government, which explored the Scottish Diaspora and compared it to that of Ireland (Ancien, et al., 2009). Two of the conclusions of the review were (a) the importance of the intangible benefits and (b) the need for any actions to work over the long term, both of which fit neatly into the aims of HS09.

Homecoming Scotland 2009

There were four formally-stated core aims of the HS09 initiative (VisitScotland, 2009b), and these are listed along with their targets:

1. To deliver additional tourism visits and revenue for Scotland: Target was to achieve a total economic impact of at least £40m;
2. To engage and mobilise the Scottish Diaspora: Target was to deliver 50,000 new consumer prospects, and 2,500 engaged 'gatekeeper' contacts;

3. To promote pride in Scots at home and abroad: Target was to create a critical mass and a rolling programme of events achieving an approval rating of at least 70%;
4. To Celebrate Scotland's outstanding contributions to the world: Target was to deliver a programme of 100+ events (funded and partner) and maximise media coverage.

Thus, central to HS09 was the leveraging of incoming tourist demand through Scottish links with the diaspora, estimated at between 28m-40m worldwide (Eirich and McLaren, 2008), living in countries throughout the world to visit Scotland in 2009, along with the engagement and participation of Scottish residents in one or more of a series of events. An integrated communication campaign urged these target groups to take part in an 'inspirational celebration' of Scottish culture, heritage and the many great contributions that Scotland has given the world in fields, such as, medicine, engineering and ship building. Reinforcing this message, was the fact that 2009 was also the 250th anniversary of the birth of Scots cultural icon and national poet Robert Burns.

A ten-month programme of more than 400 events and activities ran from Burns' weekend of the 23rd-25th January to 30th November 2009, St. Andrew's Day – Scotland's day for celebrating its national identity. HS09 focused on five themes: Burns, Golf, Whisky, Great Minds and Innovations, and Scottish Clans and Ancestry. As the ancestral home of people of Scots descent worldwide, heavily persuasive messages were used to entice the Scottish Diaspora, playing on emotional connections through the use of words, such as: *reconnect, homeland, native shores, come home, kindle pride, the promise of return*. These intangible emotions were combined with more tangible anchors, such as for example, key events like the Gathering 2009. This particular event, seen as emblematic of the spirit of HS09, was held in July 2009 in Edinburgh's Holyrood Park/Queens Park, attracting more than 47,000 people of Scots ancestry to the festival. It was the world's largest clan gathering and Highland Games, some 20,000 spectators lined the streets of the Royal Mile in Edinburgh as well as many thousands who took part in the actual Clan Parade from Holyrood to Edinburgh Castle. As part of the marketing activities 'Gathering Passports' to all associated events were sold in advance to visitors from the following countries: 38% to the USA, 35% to the UK, 10% Canada, 7% Australia, 2% New Zealand; and 8% to the rest of the world. These passports, which had 'passport stamps' added at each event attended encouraged visitors to participate in as many events as possible, and to take home as a memento of HS09, which could act as a reminder to visit at some date in the future.

Although HS09 had been developed as a tourism marketing event, it also represented an example of political intervention, which implemented a nation-wide campaign, co-ordinating, promoting and encouraging partnerships, and

providing grants for events that meet the initiative's aims and objectives. Furthermore, the concept of public-private partnership was central to HS09, with VisitScotland taking the role as the 'lead entrepreneur' in the process by providing impetus, funding, structure, staff support, marketing opportunities and incentives to co-ordinate and partner collaboration in HS09. This is reflected in VisitScotland's umbrella strategy, which explicitly used the slogan: '*one team for tourism working in partnership*'. Furthermore, VisitScotland emphasises that: '*we will operate our business as one team, on best value principles, through a combination of management and delivery against co-ordinated national and local tourism growth agendas*'. This centrality of partnership was supported by the then Chairman of VisitScotland, Peter Lederer who stated that '*Homecoming Scotland is perhaps THE best example of how partnership working can make a real difference, with Team Scotland pulling together behind one common theme*' (Lederer, 2009). One illustration of this partnership theme was the Burns' Light event in Dumfries, when 17,500 people took part in an outdoor spectacle to celebrate the launch of HS09. People across this region attended this event, with ninety-two different community groups taking part. This regional aspect reflects an important feature of HS09, that of deliberately encouraging the dispersal of tourism activity from the metropolitan centres of Edinburgh and Glasgow.

There is no doubt that HS09 financial incentives; and the HS09 marketing and promotion strategies helped to stimulate action at the local, regional and national levels. This facilitated the participation of public and private partners in the initiative, which allowed the development and packaging of a series of related products under the HS09 brand, to the mutual benefit of all partners. The concept of public-private partnerships '*emerged in the early 1990s as a development of the then Conservative Government's approach to questions of public-sector funding and the quality of public-service provision*' (Falconer & McLaughlin, 2000). Although opposed by the UK Labour Government when elected in 1997, public-private partnership has now been embraced by the main political parties as a way of developing public services, and over time has clearly developed a strong record of accomplishment. This use of public-private partnerships also represents a growing trend internationally, as it is seen to have the potential to leverage private sector knowledge, skills and resources through partnerships with industry to deliver on a range of public strategic objectives (Hall, 2005), thereby aiding their collective competitive capabilities and effectiveness (Lynch and Morrison, 2007). In the HS09 case, 'partners' took various forms, as detailed in Appendix 1. It required the skilled management of a complex process of alignment of the interests of each partner group and the HS09 project, as was found by Bhat and Milne (2008). Furthermore, this was of particular significance due to the diversity, fragmentation, and 'free-agent' or voluntary nature of the majority of the partners, such as; community groups, corporations, celebrities, population 'ambassadors' and tour operators.

Table 2: HS09 marketing, communications and programme budget

Market	EventScotland	VisitScotland	VisitBritain
UK & Ireland	£784,000	£957,000	
North America/Australia/New Zealand	£525,000	£1,353,000	
Europe		£127,000	
Emerging Markets		£216,000	
Worldwide activity (research, website, PR)	£606,000		£419,000
Total Marketing Spend	£1,915,000	£2,653,000	£419,000
Programme Spend	£3,000,000		
Supplementary Grant	£500,000		
Total Spend	£5,415,000	£2,653,000	£419,000

Source: Adapted from data supplied to Scottish Parliament Questions (S3W-21419) on the 11th March 2009

Their participation was seen as being crucial and integral to the success of a world-wide destination marketing programme, in more than forty countries.

In terms of public expenditure on HS09, in response to a number of questions from Members of the Scottish Parliament (MSPs) to the Tourism Minister (Scottish Parliament, 2009a) he indicated that HS09 had a core budget of £5.5m (table 2). From this budget, £3m was allocated to programme expenditure (supporting events, etc.) and £1.9m for marketing and communications, which was supplemented by an additional in-year grant of £0.5m. To support HS09, VisitScotland also undertook additional marketing activity (£2.65m) with Homecoming as theme running through its marketing campaigns, particularly through its "I am a Scot campaign". VisitBritain also supported HS09 with an expenditure of some £0.42m. In total, these three agencies provided a total planned marketing spend of almost £5.5m, plus £3m on programme activity, to give an overall spend of almost £8.5m on HS09 activities. In addition, a number of agencies provided almost £0.5m of direct financial support to the Gathering 2009, plus a short-term loan of £180,000 from the Scottish Government, which subsequently was written-off when the company managing the event was liquidated (Audit Scotland, 2010).

This expenditure on HS09 of course, excludes direct spend by the many other public, private and voluntary organisations that supported HS09 by staging events, and indirect support, for example 'free' bus-side advertising worth an estimated £70,000.

Homecoming's communication strategy

Scotland possesses a wealth of attributes, which are regarded as being inalienably Scottish. These are generally not substitutable; and appear to inspire a significant degree of consumer loyalty and motivation to visit, not only in tourists but also in Scots themselves. As such, Scotland can be regarded as a niche destination with competitive advantage and enduring retention of unique appeal, strongly positioning it as a tourist destination for the diaspora target

market. Given the core theme of HS09, it is not surprising that the HS09 marketing campaign content drew heavily on the traditional images of Scotland, and crafted messages evocative of 'returning home to Scotland'. Through marketing stimuli, it aimed to tap into the consumer's affinity for Scotland, their emotional attachment, sense of belonging, mythology and romance in the selling proposition. Central to the strategy was the simple, focused message in the memorable and evocative slogan 'Homecoming Scotland', cutting through the 'noise' of messages bombarding consumers from a wide variety of media and competing tourism destinations (Ryan, 2005). An integrated communication strategy was developed involving partner groups and VisitScotland in an attempt to promote with one voice the key USPs of HS09. It unashamedly employed an arsenal of powerful imagery of place, products, services, sport and entertainment, traditionally associated with Scotland, and was designed to reconnect the diaspora with the past and present, while also aiming to showcase 'modern Scotland' with a promise of more achievements in the future. This concept was also endorsed by the Ancien (2009) study on Scottish Diaspora for the Scottish Government.

However, this communications strategy did not take place in a vacuum. While the HS09 activities were about celebrating national identity and achievements, some national and international issues were sending out contradictory messages that had the potential to create dissonance with those emanating from HS09. For example, the:

- Released Libyan Lockerbie bomber arrived in Tripoli to be greeted by Scottish Saltire flags being waved;
- Scotland's football team failed to make it to the 2010 World Cup in South Africa;
- Harris Tweed company's decision to drop Scotland as a brand selling point;
- Drinks' giant Diageo closed the Kilmarnock bottling plant of Johnnie Walker whisky, moving it to Fife, thereby removing the link between image/roots, which could be a precedent for any future moves;

- Scotland (along with the rest of UK and the Western World) experienced the worst economic recession since the 2nd World War and in Scotland unemployment rose between October 2008 and October 2009 from 67,000 to 194,000, representing 7.2% of the working population;
- The almost complete collapse of the Royal Bank of Scotland, which had been seen around the world as a symbol of the dynamic economy of Scotland;
- The opposition to the Trump golf resort development in Aberdeenshire.

Furthermore, the merits of tourism destination marketing on the basis of traditional images were being debated. Some brand experts insist that Scotland's brand equity retains resilience, power and positive imagery in the wider world, such as, Worthington (cited in Kemp, 2009: 8) who said: *'Scotland has to maintain and protect the quality of its iconic images [kilts, haggis, whisky, bagpipes, golf] – and not allow things to slip or become pure tartan tat'*. Kemp disagrees: *'In Scotland there has been much navel-gazing about the kiltfest that has been HS09. As it moves towards a conclusion there have been many questioning its validity and portrayal of modern Scotland'*. This is supported by Blythman (2009) who judges the aforementioned iconic images as *'so last century'*. It must be recognised that with a limited marketing budget for HS09, VisitScotland opted to target safe markets which had an established pattern of travel to Scotland. Nevertheless, initiatives to attract visitors to Scotland do not have to be kitsch, stereotypical, inward-looking, and addressing only wealthy whites from the US, Canada and the Antipodes, while ignoring Europeans along with all the people of colour with Scottish ties. For example, despite the proliferation of Jamaicans with Scottish blood and clan family names originating from the days of slavery, the country was not identified as a target market. There was also little attempt to link HS09 into the wider overseas Scottish and UK business networks.

Thus, opinion is split. On one hand is the perception that the value of Scotland's heritage to the economy is significant in defining, communicating and positioning its "personality" as a tourism destination. For example, the ubiquitous tartan shortbread tin, with Walkers launching a special edition featuring Robert Burns, which helped to promote HS09 in about seventy countries. The tin featured a picture of the national poet and a new variety of shortbread shapes, including a thistle and lion rampant (the symbol of the Scottish monarchy). The global brand Coca-Cola's endorsement (see Appendix 1) can be taken as a vote of confidence in the pulling-power of Scotland's global connections, with Scotland's First Minister saying that it: *'translates our heritage and identity into the language of popular culture and highlights Scotland's contribution to the world'* (Scottish Government, 2009b). In contrast, there was a call to disassociate Scotland from historic icons that are viewed as pulling the country back into the past, revelling in achievements gone by, rather than looking outwards, and engaging with the modern world. Thus, 'to icon or not to

icon' within the context of the 21st century seems to be a very difficult question which the country's marketing experts are grappling to understand and to manage. However, in seeking a better understanding of the dynamics at play, Hall (2005) sagely advises that it becomes important not so much to look inside tourism for explanations but rather outside, which is why the issue of politics, tourism and HS09 needs addressed.

Politics of tourism in Scotland

'Tourism is highly politicized as, in practice, tourism policies are often vehicles of national political ambitions by countries seeking to harness the economic and political benefits of a buoyant tourism industry' (Page and Connell, 2006; 297)

It can be generalised that the development of tourism in any specific country is a function of the individual government's predisposition towards this type of economic activity, and the extent to which it impacts significantly on a country's society, environment, culture and economy (Hall, 2005). However, within the Scottish context it is more complex. The primary stated aim of the SNP is to take Scotland forward to independence. Thus, HS09, which was already overtly nationalistic in nature, played perfectly into the political ideology and agenda of the day; an agenda that was explicitly nationalistic. Hence, there existed dissonance within the other political parties and HS09 became highly politicised as especially over the period, there were increasing calls for a UK election, and HS09 was seen by some Scottish politicians as a SNP driven vehicle to persuade the populace as to the value of independence. This influenced the degree of political harmony achievable across the political parties. For example, the former Scottish Labour Party leader accused *'the First Minister and the SNP are more interested in publicizing themselves and Scottish identity in Scotland than in promoting Scotland as a destination to those who live elsewhere. It was never meant to be an internal publicity campaign for Scottishness, instead of being a great investment in our future. The First Minister has been hijacking the campaign for his own personal crusade. Scotland should be outraged. I am.'* (cited in Hutcheon, 2009). In contrast, the SNP's Tourism Minister's perspective of HS09 was that: *'This year-long celebration will benefit our country in terms of additional tourism, which will contribute to our economy. But it's also an outstanding opportunity to reconnect with the Scottish Diaspora around the world and provide impetus for them to visit their homeland'* (Scottish Government, 2007b). This brings into scrutiny a government's role in serving the collective interests of the population and not the narrow self-interests of their political manifesto (Hall, 2005).

Undoubtedly, for the SNP, HS09 held considerable appeal because of its high nationalistic profile both within Scotland; for Scots and for those Scots living outside Scotland with an affinity to their "homeland". An additional attraction of HS09 was the potential to generate highly visible economic results in a short period of time, within the context of a global economic recession, which was impacting negatively on

tourism revenues and visitor numbers. HS09 was also attractive to the SNP as it took place prior to the May 2010 UK General Election. By January 2009, a number of individual members of the Scottish Parliament (but not the political parties) were publicly divided over support for HS09 and some were attacking the promotion, scope and scale of the event. Perhaps the reason for the lack of comments from the main political parties was the degree of support they provided over the years. For example, the initiative was first announced by the Liberal Democrats when they shared power with Labour, Labour supported the event in its planning stages and the SNP provided ring-fenced funding for its implementation. Evidence of this disquiet of HS09 took the form of:

- Along with calls by opposition politicians to increase the HS09 budget, concern was expressed within VisitScotland about whether HS09 could meet its stated aims, and Ministers were forced to pump an extra £500,000 into the 'troubled' HS09 campaign amid fears it was being ignored by the public. This represented an increase of 40% on EventScotland's previous direct marketing budget of £1.3m.
- A £200,000 TV advert of famous Scots singing Caledonia was not initially intended to be shown outside the UK and Ireland. Government, as well as opposition and tourism experts' outrage prompted a rapid rethink by Scottish Ministers as it was thought that HS09 was aimed only at attracting overseas visitors. However, it was often forgotten that HS09 was also aimed at encouraging UK/Irish tourists to holiday in Scotland and this television advertisement was aimed at this market segment, nevertheless the advertisement was also shown overseas.
- An HS09 promotional poster showing a crowd of stereotypical, white kilted Scots had to be redrawn after someone noticed that it was devoid of Scotland's ethnic minorities, and this went against the Scottish Government anti-racist campaign of "One Nation, Many Cultures". In later versions of the poster, a solitary Asian man was electronically adjusted into the montage.
- Although there were a number of measures to assess the general impact of HS09, as at January 2009 there were no procedures in place to monitor how many expatriates have been tempted back to Scotland by HS09.
- Delays to completion of a £21m national Robert Burns Museum in the bard's birthplace of Alloway meant that tourists travelling to the country for HS09 celebrations did not have this particular motivation to visit the area, but there were other events in Ayrshire, including the Open Championship.
- One leading Burns figure has accused HS09 of mishandling Burns (McCracken, 2008). In the bidding process for support from EventScotland for

HS09 events, it is inevitable that not all bids would be successful; several Burns-related projects had been denied HS09 funding, and the biggest Burns event of the year was not part of the official celebrations. Ironically, most of the Burns celebrations were organised by volunteers with no public funding.

- The company managing the Gathering 2009 went into liquidation, despite receiving grants of almost £0.5m from a number of Scottish agencies and the Scottish Government, as well as a short-term loan of £180,000 from the Scottish Government (Hutcheon, 2009, Audit Scotland, 2010). The First Minister acknowledged these financial difficulties and stated that Destination Edinburgh Marketing Alliance (DEMA) had issued a press release saying that they were taking over the company running the event, because of its positive economic benefits (EventScotland, 2009), along with their remaining private sector obligations. However, DEMA did not take over the company, and it went into liquidation (Audit Scotland, 2010).

'Homecoming was never going to be anything other than a dull, hackneyed vanity project for the SNP. With its tired, old, unimaginative Scottish Tourist Board fixation on tartan, ancestry and that clichéd dirge, Caledonia, it was meant to make us all feel more patriotic and thus more inclined to vote SNP, as well as making Scotland irresistible to visitors.' (Blythman, 2009:3)

Measurements of success?

As previously stated HS09 had its 'Final Fling' event on St. Andrew's Day, 30th November 2009 with a series of 40 events across the finale weekend, so any definitive statements regarding its success or otherwise are premature at the time of writing. Furthermore, VisitScotland has commissioned EKOS consultants (a company specialising in economic and social development) to conduct an extensive performance monitoring and evaluation study, which was undertaken between March 2009 – March 2010, from which an interim report was published in April 2010 (VisitScotland 2010a). Audit Scotland (2010) will also be conducting a review of the Gathering 2009, which will look at the governance and financial management of the event and will "include a review of the Scottish Government's decision to provide additional funding to the event in the form of a short-term loan to the event-management company". In addition, it is likely that the Scottish Parliament, through its research arm (SPICe) will commission an independent researcher to undertake an external research study of HS09 (Scottish Parliament, 2010a). They reported that VisitScotland's study on the impact of HS09 would be derived principally from three sources, all of which will be independently evaluated:

- *Economic assessment:* An economic impact assessment will be undertaken by EKOS consultants, as all funded events were required to

submit Event Outcome Reports that focused on economic impact. Assessment of some of the bigger events e.g. The Gathering 2009 was supplemented by additional research fieldwork (EventScotland, 2009). Partner events (non-funded) will also be evaluated in the context of economic impact assessment. In addition, identification of long-term legacy outcomes for the events industry etc. will be identified and developed.

- *Conversion studies:* Will be undertaken by TNS, a market research consultancy, with respondents to international and national campaigns will be surveyed, participation in HS09 events, and effectiveness of marketing materials.
- *Media coverage:* Media Measurements will be used to assess the reach, value, quality and tone of messages.

On an ongoing basis throughout 2009, performance monitoring measures were developed and included:

- Advertising and Brand Diagnostics;
- Regular YouGov polling – awareness, approval, and propensity to attend events;
- Variety of web metrics which convey levels of engagement with HS09;
- Database additions;
- Response rates to e-communications;
- Ongoing media coverage evaluation; and
- Ongoing feedback from events organisers.

However, because of a variety of reasons there was an expectation that HS09 was attracting additional visitors to Scotland and these would be further boosted by increased numbers of Britons taking their holidays at home (staycations), as a result of the economic recession, and Europeans benefiting from the strength of the Euro (VisitScotland, 2009d). Examples include:

- During the May Whisky Month, the 10th Spirit of Speyside Whisky Festival, 10 day 'dramfest', with 40 events, is expected to be worth £750,000 to the local economy. It recorded increased numbers of overseas visitors with the largest numbers coming from Germany, Italy, Netherlands, Sweden, Norway and the US. It offered a chance to explore Scotland's five malt whisky regions, the Highlands, the Lowlands, Speyside, Islay and Campbeltown.
- The Royal Highland Show broke all previous attendance records, with almost 177,000 visitors, up 15,000 on 2008. This included doubling the number of international visitors, which accounted for 3,000 from 29 countries.
- The Gathering 2009, one of the major events in the Programme, made a loss as has been stated above. An independent economic impact assessment (EventScotland, 2009) showed that the Gathering 2009 generated £10.4m in revenue

for Scotland with Edinburgh accounting for £8.8m of the total. The report highlights the fact that 73% of visitors to the Gathering 2009 would be likely to visit a future Gathering within the next four years.

Furthermore, relative to the success of the communication strategy, as at October 2009, some £28m of PR coverage had been achieved, equating to 4,500 articles across the world, being seen by 78m people globally. It also resulted in 87% of the Scottish public being aware of HS09 by July 2009, compared to 29% in August 2008, and 75% 'strongly agree' or 'agree' that it was a good thing for Scotland (YouGov Poll).

Given the objectives of HS09 as outlined in the introduction, VisitScotland has released the results of some initial work, and concluded that HS09 'is well on track to deliver its stated aims' (VisitScotland 2010a):

- £19.1m of additional income from 25 of the 112 funded events analysed to date;
- 14.7% increase in trips from EU15 countries in the first six months of 2009;
- 3.4% increase in visits to attractions (Jan-Sept 2009)
- 11% increase in Scots holidays tourist's trips and 3.5% increase from UK holidays tourist trips in Scotland;
- Overseas visitors to Scotland were down slightly, but compared well to the UK figures;
- Guesthouse and B&B occupancy rates in Scotland were up by 3%, but steady across other parts of the UK;
- £40m of media coverage from more than 40 countries
- 200,000 new visitor prospects from names added to VisitScotland database, from 6,500 organisations across the world;
- 87% awareness of Homecoming in Scotland;
- 25m visits to all Homecoming related websites;
- 71% of tourism business in Scotland claimed that HS09 had been a positive initiative for Scotland;
- 86 international travel companies developed HS09 themed products and 53 international operators carried HS09.
- **Source:** HS09 Evaluation VisitScotland 2010a

The above interim report does not include data from approximately 300 'partner' events, nor from the conversion studies being undertaken by TNS to evaluate the impact of advertising. However, the EKOS study does suggest that HS09 is well on target to deliver the target of "£44m of additional income to Scotland", with the analysis undertaken of the 25 events so far suggesting a "net additional expenditure attributable to Homecoming of £19.1" against a target of £40m (VisitScotland, 2010a).

Conclusions

In terms of conclusions, according to Lederer (2009), the recent Chairman of VisitScotland, HS09:

- will greatly assist with the planning of future major events and national initiatives;
- has provided a catalyst for lasting and positive engagement with Scotland's Diaspora around the world;
- generated the most comprehensive database of Scots interest groups around the world; and
- added value to Scotland on the global stage as a place to visit, study, invest or live.

The success of any project can be measured by many criteria, but they should at least be measured by reviewing the four aims of HS09, and assessing them against these aims:

1. To deliver additional tourism visits and revenue for Scotland: Target was to achieve a total economic impact of at least £40m. The 2009 tourism data does suggest an increase in visits, while the EKOS study for VisitScotland indicates an increase in tourism revenue, although it would be interesting to explore the split in benefits between the private and public sectors.
2. To engage and mobilise the Scottish Diaspora: Target was to deliver 50,000 new consumer prospects, and 2,500 engaged 'gatekeeper' contacts. By October 2009, some 200,000 new visitors' names were added to the VisitScotland database along with 6,500 new organisations contacts.
3. To promote pride in Scots at home and abroad: Target was to create a critical mass and rolling programme of events achieving an approval rating of at least 70%. The October 2009 approval rating amongst Scots was measured at 75%.
4. To celebrate Scotland's outstanding contributions to the world: Target was to deliver a programme of 100+ events (funded and partner supported) and maximise media coverage. The media coverage is estimated at £40m, while some 400 events took place, and by October 2009 an estimated £28m of media coverage had been achieved.

The processes and procedures to develop these targets are very unclear, as is the question as to who actually set the targets and whether they are really smart and challenging targets, for example:

1. What is really meant by £40m of economic impact, and could the HS09 budget be better spent on other activities? Should the £40m of economic impacts be judged against the full economic costs of supporting HS09, not just HS09 direct marketing costs?
2. Engaging the Scottish Diaspora is fine, but what does this mean? Collecting contact details on

individuals and organisations is not really engagement, it is a mechanical process, what about the cost of updating and maintaining this database? Also engagement does not necessarily imply action?

3. Pride at home and abroad, is fine, but why only measure approval by Scots? Also approval does not imply support, nor is it the same as pride?
4. Media coverage again is fine, but what is really being measured are advertising costs equivalency rates, that is the cost of buying the same amount of media coverage, but would you want to buy this media coverage?

As with all marketing activities, there are always questions about its effectiveness and long-term benefits, and HS09 is no different. Some questions worth asking are:

1. in terms of economic benefits, there are indications that Scotland did attract extra visitors, but questions remain as to whether these were truly additional tourists, or whether their trips would have occurred anyway, in 2009 or in subsequent years.
2. We may also have to wait to see if HS09 had any impact in terms of temporal displacements, that is trips brought forward from some date in the future.
3. As to the impact of HS09 on the generation of future visits to Scotland, it is very difficult to understand how this will be monitored?
4. External factors may also had impacted on HS09, such the strength of the Euro in 2009 and the degree to which this influenced Europeans attending HS09 events is unclear. It could be that they attended HS09 events because they happened to be in the area, and their participation had little to do with HS09?
5. While the focus of HS09 was on the overseas markets, did it influence the UK markets, or was any increase in UK visitors driven by the recession and an increase in the popularity of staycations?
6. The lead in-time from the initial allocation of funds and the development of the HS09 team in 2007, to the staging of Homecoming events in 2009 was very short?
7. The issue of legacy benefits, particularly in terms of developing sustainable events that may have an economic impact both locally and nationally, is unclear. As with all such events, perhaps many of the benefits are and will remain unseen, benefits such as an increase in co-operation between the public and private sector, development of event-management skills, development of new audiences, making new international contacts may all prove to be beneficial, but maybe immeasurable in quantitative terms?
8. While the development of marketing databases does make it easier to keep in contact with prospective visitors, these are expensive to

- maintain, so will investment and staffing resources be provided to keep the databases up to date?
9. The measurement of pride in Scotland, as stated in the aims of HS09, is very difficult to track, this is much more than awareness, the basis of the current measurement, so how will this be monitored?
 10. The non-tourism wider impacts of HS09 have been extolled by some, but these wider impacts such as living, studying or investing in Scotland are very difficult to investigate?
 11. How many of the HS09 supported events were organised specifically because of Homecoming, or were they already annual events with Homecoming added to the title, just to get funds from EventScotland?
 12. The long-term sustainability of events funded by HS09 is unclear, given that many events received financial support from EventScotland, is there an expectation of future public sector funding or has HS09 funding provided them with a confidence that they can now manage on their own?
 13. Given the often stated aim of tourism is to spread its benefits both seasonally and temporally, an analysis of the distribution of HS09 supported events, may prove to be interesting?
 14. The extensive use of volunteers in many HS09 events may support the argument that HS09 was successful, as these events did not have to rely so much on public funding?
 15. Perhaps HS09 did help to dispel some of the deep-seated concerns in Scotland of the often discredited public-private partnerships, and helped to show that sometimes it can work when we accept that both sectors have a role in developing tourism. Therefore, could HS09 be seen as a good example of the effectiveness of public-private partnerships?
 16. Given that most of financial benefits of HS09 accrued to the private sector, what payback is there for the public sector from its investment in HS09?
 17. Comparison with similar event in other parts of the world, may help in any benchmarking of HS09?

Maybe the real issue is how to better measure returns on marketing activity. While the Treasury Green book (Treasury, 2003) is the standard tool used to assess investment projects, it is not really suitable for soft activities, like tourism marketing. If there is one clear message from this review, it is the real need for a standardised and agreed approach across all government marketing activities, on measuring marketing effectiveness.

Perhaps the lasting benefit of HS09 is that it has established EventScotland as a major player in event organisation, funding and promotion. HS09 also showed that Scotland could develop additional capacity in event tourism, but we may need to wait to see how many of the events associated

with HS09 are sustainable in the long-term. Although VisitScotland has suggested that HS09 will be repeated within the next four to five years (Anon, 2010). Given the willingness on the part of both the private and public sectors to co-operate in the organisation of an international event such as HS09, it did show that Scotland could play on the world stage. Whether this ability to play on the world stage is then hijacked for overtly political purposes, remains unclear.

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Appendix 1: HS09 Examples of Partners

Partners Group	Examples
Other government agencies	Scottish Arts Council, Scottish Enterprise, Highlands and Islands Enterprise, Scottish Natural Heritage, Historic Scotland, Forestry Commission, Convention Scotland, SportScotland, National Trust for Scotland (not a government agency)
Formally funded events	The Gathering 2009, Highland Homecoming, Homecoming Live – the Final Fling,
Non-funded events/ in programme	Co-branding with Turnberry Open Golf Championship, Edinburgh Military Tattoo, Fashion Awards, Forbes CEO Forum, Celtic Connections, Tiree Wave Classic, Royal National Mod
Corporations	30+ of Scotland's biggest brands and most successful companies e.g. Clydesdale Bank, Famous Grouse, Walker's Shortbread, Tunnocks. Tesco involved 30+ Scottish suppliers in HS09 promotion, reaching c. 2m customers. First Group donated adverts on three of its double-decker buses, with a commercial value of more than £70,000, to further awareness. Coca Cola launched a limited edition of c. 1m HS Coke bottle featuring an iconic image of Robert Burns, the first time an individual has been immortalised on a Coca-Cola bottle, and designated to one nation.
Celebrity Ambassadors	Scottish celebrities were recruited, giving time and testimonial for free for the 'greater good' e.g. Sir Sean Connery, Chris Hoy, Lulu, Sam Torrance, Sandi Thom. Contributed to VisitScotland/EventScotland produced advert using Dougie MacLean's song Caledonia, and a DVD promoting golf premiered at the 2008 Ryder Cup at Valhalla Golf Club in the US.
Travel agents	Number trained to promote Scotland increased by more than 1000 to 5000 to coincide with the HS09 campaign. This is as a result of the Visit Scotland specialist Scots Agents' programme, an online education package.
Population ambassadors	Aimed to inspire people in Scotland to get involved as a crucial element of promotion, for Scots to get in touch with friends and family around the world and invite them to join in the celebrations.
Regional communities	Assisted by ERDF and HS09 funding, events organised in rural communities to push traffic out of metropolitan areas into the regions.
Cities	Edinburgh International Festivals, World Pipe Band Championship
Hospitality and Tourism trades	Created specific HS09 packages, offers, etc. tied into the events programme within particular geographic locations

Source: Visit Scotland (2009b)

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*Professor Alison Morrison
School of Management, Division of Hospitality & Tourism
University of Surrey, Guildford GU1 7XH
a.morrison@surrey.ac.uk

**Professor Brian Hay
Visiting Professor, Strathclyde University Business School
Glasgow G1 1XQ/
Visiting Professor, School of Business, Enterprise & Management,
Queen Margaret University,
Edinburgh EH21 6UU
BHay@gmu.ac.uk

The structure of employment and graduate employment in Scotland, 2001 – 2009

John Sutherland

John Sutherland is an economist at the Centre for Public Policy for Regions, based at the University of Glasgow.

Introduction

The current policy scenario in Scotland presumes the development of what is commonly referred to as a 'knowledge economy'. Moreover, the policy assumption is that, in time, most of those who participate in the labour market will find work in occupations compatible with being 'knowledge workers', subsequent to and consequential of personal human capital investment in education, most especially to degree level (Reich, 1993; Warhurst, 2008). This is reflected in the Scottish Government's lifelong skills strategy which offers the vision of "a smarter Scotland, with a globally competitive economy based on high value jobs" (Scottish Government, 2007, p. 4). It is the principal basis for the Scottish Government's encouragement – both vocal and financial, especially in terms of its 'no fees' policy – for yet more to enter into degree and degree equivalent programmes of study.

How has industrial and occupational employment in Scotland changed between 2001 and 2009? In which industrial sectors and occupational groupings have those with graduate status found jobs? Have these changed over this period? Are the prospects for potential graduates of the future worth the personal financial costs this investment entails? And should the Scottish Government persist with a skills policy which places so much emphasis on the production of yet more graduates?

The answers to some of these questions are presented in the sections which follow.

The labour market context

Between May 1995 and September 2008, employment in Scotland increased by (approximately) 285,200 or by over 12 percent. The unemployment rate decreased by 4.3 percentage points, from 8.8 percent to 4.5 (cf. Figure 1). Over the period, female employment did expand by 6 percentage points more than male employment, but, nonetheless, for many in Scotland – and elsewhere in the

United Kingdom, for that matter – these were propitious times in terms of the employment opportunities available.

These times came to an abrupt end in the last quarter of 2008, however, as the consequences of the financial crises prompted by the failure of Lehman Brothers compounded the problem of an imminent decline in demand in the world economy¹. Between the second (calendar) quarter of 2008 and the second (calendar) quarter of 2009, approximately 36,000 jobs were lost in Scotland, some 1.5 percent of the 2008 total. That said, the magnitude of total job loss was not as great as many forecasters had feared. Many employers met declining demand for their goods and services by reducing the number of hours many of their employees worked rather than dismissing them, as had been a common practice during previous recessions. This strategy, however, has obvious limitations and implications. Any future decrease in labour demand may have a proportionately greater impact on unemployment. Conversely, any marginal increase in labour demand will do little to alleviate unemployment. If economic growth is observed, it will be 'job-less growth'.

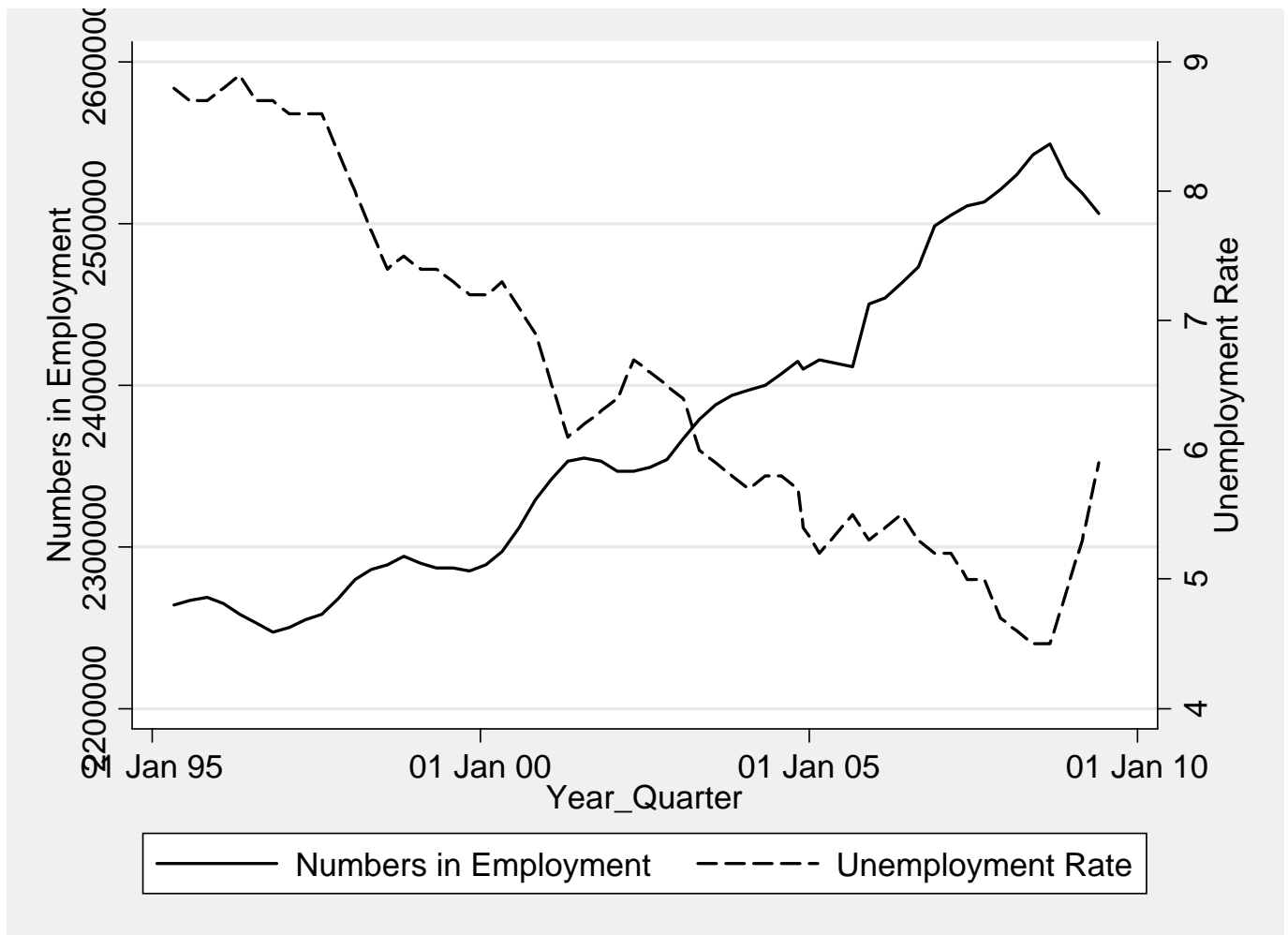
Given this context, therefore, statistics which relate to the structure of industry by employment, occupational structure and graduate employment over the period 2001 – 2009 are better examined for two sub periods: the first for the years 2001 and 2008, the end of the era of long run economic expansion; and the second for the years 2008 and 2009, the beginning of the period during which the economy was in recession.

The structure of industry, by employment

Individuals are recruited by business enterprises and organisations and employed at workplaces. Workplaces are classified according to the nature of the economic activity undertaken, a classification known as the Standard Industrial Classification (SIC). Change in the structure of industrial employment reflects both the change in demand for products and services and how these products and services are produced and provided. For example, product demand within a sector may increase yet employment there fall because the technology used has changed and requires proportionately less labour per unit of output.

The distribution of employment by industry for the years 2001, 2008 and 2009 is presented in Table 1. In 2009, almost two thirds of those in employment were working in three industrial sectors, in order of their relative importance: Public Administration, Education and Health; Distribution, Hotels and Restaurants; and Banking Insurance and Finance. Public Administration, Education and Health illustrates one important feature of employment in Scotland: segmentation by gender, how certain industrial sectors may be identified as predominantly male, for example Manufacturing, whereas certain others may be identified as predominantly female, for example Public Administration, Education and Health. Another important feature is that

Figure 1: Employment and unemployment, May 1995-June 2009



Source: NOMIS

employment expansion has tended to advantage the 'female' industrial sectors and disadvantage the 'male'.

The public sector (to be distinguished from the industrial sector Public Administration, Education and Health) plays a significant – and often seen as controversial - role within the Scottish economy (Cumbers, 2007). Three in ten workers were employed in the public sector in Scotland in 2009, approximately two thirds of whom were female.

Occupational structure

Whereas the SIC classifies workplaces according to the economic activity undertaken there, so the Standard Occupational Classification (SOC) categorises their workforces according to what individuals do, in an implicit hierarchy reflecting the knowledge and skills required to do the job. Consequently, as industrial sectors within the economy expand and contract, a process referred to as 'sectoral change', this will impact upon occupational structure. However, separately and simultaneously, there is

another process on-going, referred to as a process of 'structural change', as workplaces change the nature of labour they employ, principally, although not exclusively, as a consequence of technical change. In principle, 'structural change' in terms of its occupational impact may be either 'de-skilling' or 'up-skilling', where the former entails the employment of proportionately more less skilled workers and the latter entails the employment of proportionately more high skilled workers.

The distribution of employment by occupation for the years 2001, 2008 and 2009 is presented in Table 2. Note again, the prevalence of gender segmentation, with some occupations (e.g. Skilled Trades Occupations) being predominantly male and others (e.g. Administrative and Secretarial) being predominantly female. In 2009, the three most populous occupational groupings were, in order of their relative importance: Associate Professional and Technical, Managers and Senior Officials and Professional Occupations, constituting approximately 45 percent of total

Table 1: The structure of industry, by employment: 2001, 2008 and 2009

	2001		2008		2009	
	Employment (‘000s)	Of Which Male (%)	Employment (‘000s)	Of Which Male (%)	Employment (‘000s)	Of Which Male (%)
Agriculture and Fishing	57.5	78.1	56.6	77.4	28.5	84.5
Energy and Water	64.2	85.2	89.9	75.4	71.3	76.1
Manufacturing	336.5	69.9	251.4	76.2	172.8	81.1
Construction	178.1	90.3	209.3	88.6	179.2	87.8
Distribution, Hotels And Restaurants	453.5	42.3	478.2	47.3	411.4	48.8
Transport and Communication	161.2	74.2	144.7	77.9	147.6	76.3
Banking, Insurance And Finance	287.4	52.8	351.0	54.7	346.9	54.4
Public Administration, Education and Health	668.8	29.4	805.3	30.3	725.3	30.2
Other Services	132.4	50.0	149.4	41.7	122.5	43.7
Total (all Industries)	2,340.1		2,536.2		2,205.3	
‘Public Sector’	652.2	36.8	695.8	35.4	662.3	35.6

Notes to Tables 1 through to 6: The data have their origin in the second (calendar) quarter of the Labour Force Survey, a quarterly sample survey of households living at private addresses in Great Britain which, inter alia, seeks information about respondents’ personal characteristics (such as gender and qualifications) and labour market status (such as their workplace if in employment and occupation). Industry and occupation data refer to the individual’s main job. Observations with missing or incomplete information are omitted from the analysis. For example, in the surveys > 10 percent do not respond to questions about qualifications. The incidence of omission varies across the three calendar periods examined. This factor part explains the apparent discrepancies between the ‘total’ employment numbers which appear in these tables and the corresponding statistics used in the construction of Figure 1. It also means that direct cross year comparisons should be resisted or, if undertaken, the interpretation of the results should be treated with some caution.

Table 2: Occupational structure: 2001, 2008 and 2009

	2001		2008		2009	
	Employment (‘000s)	Of Which Male (%)	Employment (‘000s)	Of Which Male (%)	Employment (‘000s)	Of Which Male (%)
Managers and Senior Officials	273.3	69.5	340.5	65.3	328.5	63.3
Professional Occupations	265.8	55.3	336.1	54.1	318.9	52.1
Associate Professional and Technical	307.1	48.1	380.1	47.3	348.4	50.9
Administrative and Secretarial	309.1	20.4	277.2	19.0	262.8	20.2
Skilled Trades Occupations	287.3	91.5	280.8	92.3	235.8	92.9
Personal Service Occupations	171.7	15.9	232.4	17.8	201.6	16.3
Sales and Customer Service Occupations	206.5	27.5	205.7	33.1	171.9	32.9
Process, Plant and Machine Operatives	218.8	80.3	184.5	87.9	133.9	92.2
Elementary Occupations	299.6	51.4	298.1	53.1	202.9	55.7
Total (All Occupations)	2,340.1		2,536.2		2,205.3	

Table 3: Percentage distribution of individuals who had graduate status, by industry: 2001, 2008 and 2009

	2001	2008	2009
Agriculture and Fishing	1.1	0.5	0.7
Energy and Water	3.7	5.0	2.9
Manufacturing	10.1	7.0	4.7
Construction	3.6	2.7	4.8
Distribution, Hotels And Restaurants	8.7	7.2	9.1
Transport and Communication	2.5	3.1	5.4
Banking, Insurance And Finance	19.1	21.9	20.7
Public Administration, Education and Health	46.9	46.9	46.3
Other Services	4.3	5.8	5.3
Total (all Industries)	100.0	100.0	100.0
'Public Sector' (as opposed to 'private sector')	45.0	41.5	44.3
Number who have graduate status	366,168	511,861	516,525

Note to Tables 3 and 5: Because of rounding, totals may not sum to 100.0

Table 4: Percentage within the industry who had graduate status: 2001, 2008 and 2009

	2001	2008	2009
Agriculture and Fishing	7.0	4.9	12.6
Energy and Water	21.3	28.6	21.3
Manufacturing	11.0	13.8	14.1
Construction	7.4	6.7	13.7
Distribution, Hotels And Restaurants	7.1	7.7	11.5
Transport and Communication	5.6	10.9	19.0
Banking, Insurance And Finance	24.2	32.0	30.9
Public Administration, Education and Health	25.6	29.8	33.0
Other Services	11.8	20.0	22.4
Total (all Industries)	15.6	20.2	23.4
'Public Sector'	25.3	30.5	34.5
Number who have graduate status	366,168	511,861	516,525

employment. Each of these occupational groupings is conventionally associated with 'knowledge workers', and, notably, their combined share in the distribution increases across the three years examined. In essence, therefore, occupational change over the period has been compatible with what is associated with the development of a 'knowledge economy'.

Graduate employment

How the stock of those who had graduate status was distributed across industrial sectors in the 2001, 2008 and 2009 is identified in Table 3². Nearly half were employed in Public Administration, Education and Health. There was a similarly high level of concentration of graduates in the public (as opposed to the private) sector. The only other industrial sector which employed a significantly large proportion of graduates was Banking, Insurance and Finance.

The percentage of workers who had graduate status within each industrial sector is reported in Table 4. In 2009, almost one in four workers had graduate status. The percentage of workers who had graduate status was noticeably larger in two industrial sectors: Public Administration and Health (at 33.0 percent) and Banking, Insurance and Finance (at 30.9 percent). 34.5 percent of workers in the public sector had graduate status in 2009. If 'up-skilling' is to be measured in terms of the percentage of workers within an industrial sector who have graduate status, this process would appear to be evident over the period across most industrial sectors in Scotland. Given the qualification levels required for entry to certain occupations within the SOC, the expectations are that, first, the percentage distribution of individuals who had graduate status will be skewed towards the upper end of the occupational hierarchy and, second, proportionately more individuals within these 'higher' occupational groupings will have graduate status. This proves to be the case, as demonstrated in Tables 5 and 6.

In 2009, more than four in every five individuals who had graduate status were employed in the top three occupational groupings, in order of their relative importance: Professional Occupations; Managers and Senior Officials; and Associate Professional and Technical. This distribution appears to have changed only marginally over the period (cf. Table 5). Two in every three employed within Professional Occupations had degree status in 2009. One in every three employed within Managers and Senior Officials and Associate Professional and Technical had degree status in the same year (cf. Table 6).

That individuals with graduate status were seen to be employed in the other six occupational groupings would be seen by some to be a possible manifestation of 'over-education' i.e. not being in jobs commensurate with the level of qualifications held (cf. Table 5) (Dolton and Vignoles, 2000; Sloane et al, 1999). Moreover, the incidence of 'over-education' would appear to be increasing, in that the percentage of individuals who had graduate status generally

increased in most of these occupational groupings over the period (cf. Table 6).

Employment prospects for graduates

Higher education underwent a policy driven, major, sudden and traumatic systemic change in the mid 1980s, moving from an 'elite' to a 'mass' system, with the latter designed to provide opportunities in tertiary education for an increasing proportion of the school leaving population (Sutherland, 2008)³. This change had inevitable short run and long run impacts upon the graduate labour market. Despite initial fears of supply exceeding demand, the period was associated more with demand exceeding supply⁴. No longer being able to recruit quality school leavers who had now entered into higher education, employers sought graduates as substitutes; the professions requiring graduate entry diversified, from the 'traditional', such as law, medicine and teaching for example, to the 'modern', such as accounting, architecture, surveying and town planning; 'new' and 'niche' graduate jobs appeared, the former often reflecting managerial specialisms, such as 'finance', 'personnel' or 'sales', and the latter requiring the ability to apply hybrid skills, for example combining managerial skills with technical expertise, frequently in the manifold areas associated with information and communication technology (ICT) (Elias and Purcell, 2004). Graduates facilitated if not initiated the very prevalent re-organisation of work which occurred during the 1990s (Mason, 1996).

Even before the recession, however, there was accumulating evidence that the relative demand for and supply of graduates was changing. The graduate premium was declining (Green and Zhu, 2010, forthcoming); and skills under-utilisation was becoming more prevalent (Felstead and Green, 2008; Felstead et al, 2007).

Cutting the deficit will dominate fiscal policies for the foreseeable future. The new coalition government at Westminster has promised reductions in public expenditure totalling £6B in the current financial year, with the details to be confirmed in the 'emergency' budget of 22nd June. These measures will have undoubted, if incalculable, immediate and short run consequences for the macro economy. They will also impact upon the size of departmental spending budgets in England and Wales and Treasury funding received by the Scottish Government.

Approximately 30 percent of the workforce in Scotland are employed within the public sector. Moreover, approximately 35 percent of the stock of employees within this sector have graduate status, most in Professional and Associate Professional and Technical occupations, the majority of whom are female. The employment prospects for many new graduates in these areas in the immediate future, therefore, must be seen to be poor. Early evidence of this comes from the recent announcement of the Greater Glasgow and Clyde Health Board to reduce employment by over 1,000 within the next 18 months. Achieving this outcome via a policy of 'no redundancy', merely transfers the real costs of the policy

Table 5: Percentage distribution of individuals who had graduate status, by occupation: 2001, 2008 and 2009

	2001	2008	2009
Managers and Senior Officials	16.7	18.1	21.7
Professional Occupations	47.6	43.0	40.5
Associate Professional and Technical	20.8	23.6	20.9
Administrative and Secretarial	5.9	5.2	5.5
Skilled Trades Occupations	2.4	2.1	1.7
Personal Service Occupations	1.6	2.6	4.1
Sales and Customer Service Occupations	2.2	2.5	2.8
Process, Plant and Machine Operatives	1.1	1.2	0.4
Elementary Occupations	1.6	1.8	2.5
Total (All Occupations)	100.0	100.0	100.0
Number who have graduate status	366,168	511,861	516,525

Table 6: Percentage within the occupational grouping who had graduate status: 2001, 2008, 2009

	2001	2008	2009
Managers and Senior Officials	22.4	27.2	34.1
Professional Occupations	65.6	65.4	65.5
Associate Professional and Technical	24.8	31.8	30.9
Administrative and Secretarial	7.0	9.7	10.8
Skilled Trades Occupations	3.1	3.8	3.8
Personal Service Occupations	3.5	5.7	10.4
Sales and Customer Service Occupations	4.0	6.2	8.3
Process, Plant and Machine Operatives	1.8	3.3	1.5
Elementary Occupations	1.9	3.1	6.4
Total (All Occupations)	15.6	20.2	23.4
Number who have graduate status	366,168	511,861	516,525

to job seekers, either already in the labour market or about to enter into it.

But what of the longer run, when the deficit no longer constrains economic policy and the normality of modest economic and employment growth returns?

The 'knowledge' economy is known also as the 'information' economy and the 'weightless' economy, because it is associated with value added having its origins in highly qualified human capital inputs making effective use of ICT. Only a proportion of those employed within the knowledge intensive sectors of the economy, however, undertake

activities associated with Reich's 'symbolic analyst', identifying and solving problems. Many are in jobs processing information, an activity which may be undertaken anywhere because the costs of moving information across space are negligible. De-industrialisation was often the consequence of firms outsourcing their manufacturing process to low cost locations overseas, at the cost of employment opportunities for unskilled labour at home (Dicken, 2007). Call centres established overseas in the search for competitive advantage on the part of some companies have had similar detrimental employment consequences for many semi-skilled white collar workers.

The multinational firms which dominate the Banking, Insurance and Finance sector are aware of the competitive advantages which accrue from outsourcing overseas their manifold information processing activities. What will be the implications were they to increase the extent of what they already do? Will this increase the likelihood of technically very similar organisations also adopting an outsourcing strategy, for example firms within the legal sector where there is already some evidence of this? When will local authorities evaluate the probable cost savings – and possible reductions in rates, of course – which could arise from doing the same with many of their processing activities. Or the NHS, as it is driven to deliver more value for money? What then, for the future employment prospects of many graduates, 'traditional' or 'modern', 'new' or 'niche'?

Given such a scenario, what then, for the central thrust of the Scottish Government's lifelong skills strategy to produce more graduates?

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Endnotes

¹See Bell and Blanchflower (2009) for a detailed discussion of the period, and one insight into the several explanations for the turning point.

²By graduate status is meant all those who have level 4 qualifications i.e. those who hold degree equivalent, professional and vocational qualifications as well as those who have degrees.

³Simultaneously, often to rationalise the expansion of the sector, university attendance became less about learning and the acquisition of knowledge and more about the development of skills to enhance subsequent participation in the labour market on graduation.

⁴The graduate pay premium rose as a consequence, something which, in turn, was used to help rationalise the argument for the introduction of fees in England and Wales.

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EH1 1LZ

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Fax: 0131 650 6345

Email: Ladams@ed.ac.uk