Scotland Unconfined

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When Gordon Brown in his 'Britishness' speech in Edinburgh announced to his audience that 'Scottish growth rates are in line with the UK again this year' it may have been good politics but it was not good economics. The Scottish Executive, in its Economic Report of June 2006, was less disingenuous, stating that, 'the closure of the growth gap between the UK and Scotland in 2005 was primarily a result of a slowdown in the UK economy rather than an increase in Scottish growth'. Brown was referring to 2005 and the projection for 2006. Throughout the period 1997 to 2004, however, Scottish growth was around one per cent lower than the United Kingdom's, as it has been more or less since the mid-1970s.

Any serious discussion of the Scottish economy would need to analyse the reasons why this period was the turning-point in Scotland's embedded economic under-performance for the next 30 years, but that lies beyond the scope of this article. We can however throw some light upon it by comparing some features of the Scottish and Irish economies over the last decade.

One of the popular myths about Ireland's remarkable economic growth since the 1990s is that much of it is attributable to European Union subsidies. If this were true, Ireland really would have performed an economic 'miracle' in this period! But as the *Economist* put it, in a survey of the Irish economy in October 2004: 'The most authoritative studies suggest that EU subsidies may have added around 0.5 per cent a year to Ireland's growth during the 1990s – useful but modest in the context of average growth of 6.9 per cent'. It's not difficult to identify some of the main reasons for Ireland's improved performance in the last ten years. They include: an impressive increase in Irish exports; sustained production led growth; the European Union's single market and single currency; and the huge increase in employment.

Since the early 1990s, Ireland has quadrupled its volume of exports to the European Union. If

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we compare the destination of Ireland's and Scotland's exports we can identify one of the reasons why the Scottish economy has been underperforming so consistently over the last decade. According to the Executive, in 2004 63 per cent of Scotland's exports were to England, 17 per cent to the European Union, 6.5 per cent to the United States and 13.5 per cent to the rest of the world. Ireland by contrast, in 2005, supplied 46 per cent of its exports to the European Union, 19 per cent to the United States, 17 per cent to the United Kingdom and 18 per cent to the rest of the world.

Impressive as Ireland's export performance has been, it's also worth noting that in 2005 Finland provided 57 per cent of its exports to the European Union, Sweden 70 per cent and Norway 79 per cent. Future economic historians in Scotland, perhaps mindful of Brown's warning in his speech about the economic consequences of Scottish independence, may not appreciate the irony of the relative export performance that saw Ireland, in 2005, earn more from its annual exports to the United Kingdom (15.4 billion) than Scotland, in 2004, earned from its annual exports to the entire European Union (£8.8 billion).

One of the long-standing structural problems in the Scottish economy has been its narrow export-orientation. Scotland has been over-reliant on the relatively small UK market in a period when European enlargement, in all its forms since 1973, should have provided opportunities for Scotland to significantly increase its exports to the European Union. Even the Executive acknowledges that, 'the strength of the economic linkages between Scotland and the rest of the UK implies that the performance of the wider UK economy bears significantly on the performance of the Scottish economy'. This, if anything, is an understatement. But to see why Scotland's over-reliance on the United Kingdom will intensify the difficulties for the Scottish economy over the next business cycle, if not beyond, we need to look at recent developments in the UK economy.

One of the disturbing recent trends, particularly in England's economy over the last decade, has been the huge increase in consumer indebtedness. When New Labour came to power in 1997, the UK mortgage debt to gross domestic product ratio was just under 50 per cent. By 2004, it had increased to 79 per cent (the EU average in 2004 was 45 per cent). Further, since 1997, the UK level of personal consumer indebtedness (credit card debt, personal bank loans etc) has increased 300 per cent. Today, one third of the entire European Union's unsecured consumer debt is held in the United Kingdom, most of it in England.

The engine of growth here has been house price inflation. Since 1997 the United Kingdom, or rather the south-east of England, has had the highest house price inflation in the European Union. According to the Executive, throughout the period 1997 to 2004 property prices in London were two and a half times greater than in Scotland. House price inflation has produced the recent phenomenon in England of large-scale 'equity withdrawal'. As a consequence of so-called 'wealth effects', owner occupiers, in anticipation of rising house prices, have been withdrawing 'equity' i.e. borrowing money on the rising value of their property. Inevitably this house price bubble will burst in England. And as we saw in the late 1980s, when levels of indebtedness were considerably lower and less extensive than today, when this happens the consequences for the Scottish economy, which depends on England for 63 per cent of its exports, will be potentially devastating. The other problem with debt-laden consumption-led growth is that consumption spending becomes highly sensitive to interest rate increases.

Ireland meanwhile has continued its impressive growth. Since joining the Eurozone in 1999, Irish interest rates have been around 1.5 per cent lower than those in Scotland and this during a period when Ireland's economy has been growing four times faster than Scotland's! Unlike the United Kingdom, much of Ireland's growth over the last decade has been production led. This has had a more significant and sustainable impact on the real economy in Ireland – for example, on increased consumption spending related to increases in income rather than debt, on investment, export performance and so on. Indeed Ireland is now the second most productive economy in the European Union.

In October 2005, the Organisation for Economic Co-operation and Development compiled a 'league' table of the productivity and skills in developed countries. The United Kingdom was in the bottom half of this table. Of course, there has been a productivity (and skills) gap between the UK and other advanced capitalist economies since the 1950s. But one of the reasons that the UK has been unable to close this gap is because of the role of the City of London in attracting finance capital that might otherwise be put to productive use in the real economy.

Like previous UK chancellors, Brown has supported a 'strong' pound as a kind of national virility symbol. A recent report by Goldman Sachs estimates that since Brown became chancellor sterling has been overvalued by 12 per cent with inevitable consequences for manufacturing exports. Scotland, for example, has lost over 100,000 manufacturing jobs since 1999 – the official explanation for this is 'globalisation'. But as the Bank of England's *Quarterly Bulletin* put it: 'A major determinant of demand for an industry's exports is the price of those exports relative to the prices of international competitors'. And a 'strong' pound, although it has increased the business and profits of the City of London, has priced Scottish manufacturing exports out of international markets.

The desire to retain the 'independence' of sterling and the City of London's dominance as an international financial centre was also one of the primary reasons behind Brown's decision not to take sterling into the euro. The so-called 'five tests' to take sterling into the euro are in fact largely bogus, not only because they are so subjective but also because everyone knows that it is the so-called 'sixth test' i.e. could Brown win a referendum to take sterling into the euro, that really determined the decision. Having said this, the Treasury's 2003 *EMU Study* ought to be read by all Scots as it provides many compelling reasons why smaller countries like Scotland would benefit from monetary union. These reasons were not lost on the Irish. In the debate on whether Ireland should join the euro, an editorial in the *Irish Times* in March 1998 argued that failure to join would be tantamount to 'Ireland reclassifying itself, effectively, as a UK dependency'.

It might be thought that on employment Scotland has a record over the last nine years that compares favourably with Ireland. Unfortunately, this is not the case.

According to the Executive, between 1999 and the first quarter of 2006, 183,000 new jobs were created in Scotland. Of these, 59,000 were in the public sector and 124,000 in the private sector. In Ireland, between 1997 and 2005, 435,000 new jobs were created, 62,000 in the public sector and 373,000 in the private sector. Indeed, if the relative employment growth patterns of the last decade continue then, by 2015, Ireland's employed labour force would be larger than Scotland's. This would be an astonishing turnaround as it's little more than a decade ago that Scotland's employed labour force was *double* that of Ireland's.

Much of the recent debate about Scotland's continuing economic underperformance has focused on the 'crowding out' thesis. The central argument of this thesis is that 'unproductive' public investment has crowded out 'productive' private investment in the United Kingdom. But to fall back on this thesis as an explanation for Scotland's chronic underperformance is, at best, a distraction from a bigger picture. The reason that neither Scotland's public nor private sectors can emulate the performance of Ireland and other smaller European Union economies, isn't because the public sector crowds out the private sector, but because England's economy crowds out the Scottish economy. This doesn't happen by design – no one at the UK Treasury wants to see Scotland continue to lag behind other comparable countries in Europe, but there's very little they can do to prevent it.

One contributory factor here is political – England's electoral cycle crowds out Scotland's also. Since 1964, Labour has won every general election in Scotland, yet for 21 of the last 42 years Scotland has been governed by the Conservatives. If, as seems increasingly likely, David Cameron's Tories win the next UK general election, it's not clear that Scotland is prepared for the prospect of a rejuvenated Tory party anxious to flex its neo-liberal muscles in government. Whoever wins power in next May's elections to the Scottish Parliament, we urgently need to have a national debate in Scotland to produce clear policy objectives that will address and resolve some of Scotland's main economic problems.

First, how can we adopt fiscal and monetary policies that are more closely correlated to the real economy in Scotland? Second, how can we create sustainable production led growth? Third, how can we improve Scotland's dismal export performance with the European Union and the rest of the world? Fourth, how can we transform Scotland from a low wage to a high wage economy in the European Union? Fifth, how can we ensure that no worker in Scotland works for poverty wages (i.e. a minimum wage worth no less than 60 per cent of average earnings: not, as at present, 40 per cent)? Sixth, how can we address the growing imbalance in housing tenure and nullify its effects on increasing inequality as well as on the wider economy? Finally, how can we sustain stable and growing investment in Scotland's public and private sectors?

Debates are more effective when the participants have a specific question to consider. There are many economic issues competing for attention in Scotland today. But there is one political question that needs to be addressed first: what will you do if David Cameron's Tories are elected into government in 2009? It may be stating the obvious but it would not be in Scotland's interests to leave this debate until 2010.