

PRESS RELEASE

***CPPR ANALYSIS OF THE SCOTTISH GOVERNMENT PUBLICATION –
GROSS DOMESTIC PRODUCT FOR SCOTLAND FOR THE 4th QUARTER OF
2007***

HEADLINES

- **Scotland grew above its long run trend in 2007 but again below the UK**
- **Growth for Scotland in the last quarter was above the UK and Q3 data has been revised to also show faster growth than UK. This means Scotland's poor overall 2007 performance vs UK was due to a sluggish 1st half performance**
- Slower Scottish growth for **2007** (vs UK) in all major industry sectors except 'Manufacturing' and 'Transport, Storage and Communications'
- Faster **Q4** growth than UK largely down to 'Business services and Finance' and 'Other services'
- **Hotels and Catering** in Scotland continue to flat-line as opposed to the UK's continuing fast annual growth
- **Communications** is the biggest Scottish success story over the past decade, rising faster than the Banking sector in Scotland and by over three times as fast as the equivalent UK sector since 1998
- **Financial Services** have bounced back in Q4 but, along with the 'Banking' component, still shows quarter on quarter falls for Q3 and Q2. Overall growth in Scotland was only 2% in 2007, as opposed to over 11% in the UK
- **Public Sector** returned to growth in 2nd half of 2007 but overall grew by only ½ a percentage point in 2007. This is poor for a sector that accounts for almost a quarter of Scottish economic activity
- Given the importance accorded by the government to the growth in GDP/GVA, the time now seems opportune for a review of the relevant data for Scotland in light of (i) the increasing importance given by the Scottish Government to growing the economy as their primary objective and as reflected in their Targets, coupled with (ii) the current uncertainty over the true economic picture at present. For example, Regional Accounts data shows Scotland outgrowing the UK in each of the latest three years (2004-2006) whereas the Scottish Government data shows the opposite result.

Table 1: GVA by broad sector in Scotland and the UK (based on 2004 = 100)

Industry	2003 weight	growth 2007 (overall) ^a			growth 98-07% (overall) ^a			growth 98-07% (average p.a.) ^b		
		Sc	UK	Diff ^c	Sc	UK	Diff ^c	Sc	UK	Diff ^c
TOTAL	1000	2.2	2.9	0.7	20.3	27.5	7.2	2.1	2.7	0.6
Agriculture etc	16	-2.4	0.9	3.3	1.1	9.5	8.4	0.1	1.0	0.9
Production	178	-1.0	0.3	1.3	-10.7	-1.1	9.5	-1.3	-0.1	1.1
Mining etc	11	-6.7	-1.7	5.0	-27.0	-31.3	-4.3	-3.5	-4.2	-0.7
Elec, gas, water	27	-8.7	0.1	8.8	-12.5	11.2	23.7	-1.5	1.2	2.7
Manufacturing	139	0.9	0.6	-0.3	-9.2	2.4	11.7	-1.1	0.3	1.3
Construction	68	-1.7	2.4	4.1	25.7	21.8	-3.9	2.5	2.2	-0.4
Services	738	3.4	3.7	0.3	30.3	37.2	6.9	2.9	3.5	0.6
Retail & wholesale	112	3.5	3.9	0.4	20.8	36.6	15.9	2.1	3.5	1.4
Retail	55	4.3	4.2	-0.1	31.3	49.7	18.4	3.0	4.5	1.5
Wholesale & motor vehicles	57	2.8	3.9	1.0	12.3	34.9	22.6	1.3	3.3	2.0
Hotels & Rest's	35	-1.7	4.0	5.7	-0.8	38.2	39.0	-0.1	3.6	3.7
Transport & Communications	74	9.8	4.3	-5.5	62.3	52.1	-10.2	5.4	4.7	-0.7
Financial Services	83	2.0	11.1	9.2	91.2	73.0	-18.2	7.2	6.1	-1.1
Real estate & Business	193	4.4	5.5	1.1	43.9	54.7	10.7	4.0	4.8	0.8
Public Adm., Ed. & Health	230	0.6	1.5	1.0	16.7	19.7	3.0	1.7	2.0	0.3
Other services	59	7.5	3.2	-4.3	22.3	19.1	-3.2	2.2	1.9	-0.3
FISIM	-47	3.6	17.4	13.7	90.1	126.3	36.1	7.1	9.1	1.9

^a Calculated as arithmetic growth i.e. $100 \times [(Y_{end} - Y_{start}) / Y_{start}]$

^b Calculated as geometric growth i.e. $(100/9) \times \ln(Y_{end} / Y_{start})$

^c UK *minus* Scotland difference

Source: ONS (2008) and Scottish Government (2008)

SECTOR BY SECTOR

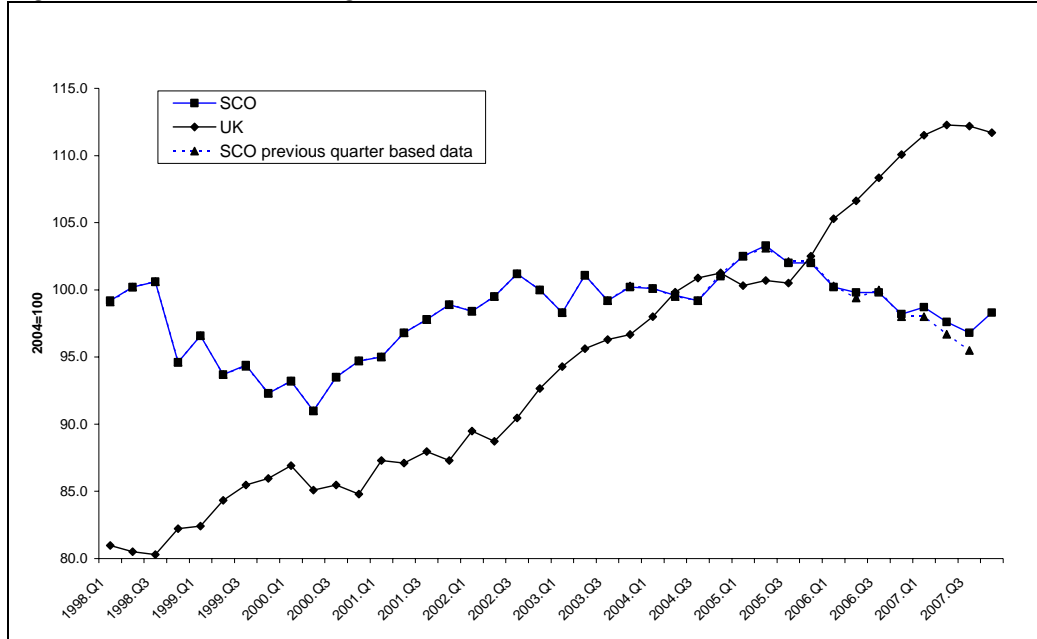
(Note: figures shown in brackets below refer to the percentage share (rounded to the nearest % point) of each sector in terms of total GVA for Scotland, based on 2004 weights)

THE RETAIL AND WHOLESALE SECTOR (11%)

The figures for retail sales were dramatically revised up at the time of the last quarterly GVA publication. There is now estimated to have been overall growth in the Retail and Wholesale sector of 31% between 1998 and 2007, although 2005 is still a very bad year.

An explanation is still needed for the substantial differences that remain between Scotland and the UK during this period. New figures, back to 1995, have recently been obtained by the Executive statisticians and are expected to be incorporated into the 2008 Q1 Scottish GVA publication.

Figure 1: Hotels and catering



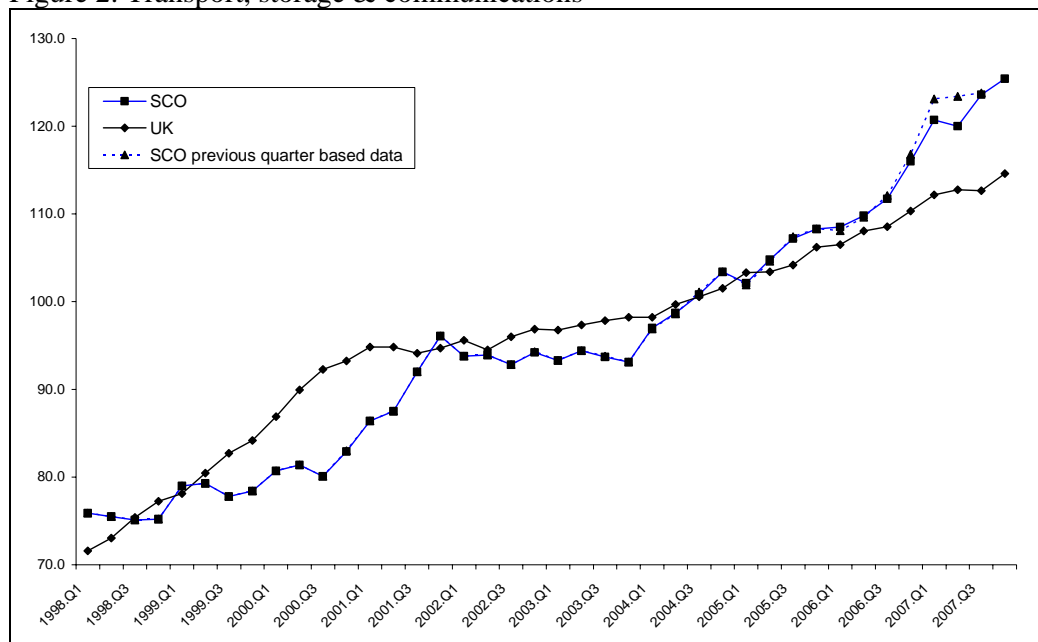
HOTELS AND CATERING (4%)

Despite a relatively good Q4 performance, this sector continues to perform very poorly in Scotland. The level of GVA in 2007 fell on 2006 and is now below that recorded for 1998. (In contrast the UK level has risen by 38% since 1998.) One of the fastest growing industry sectors in the UK continues to be one of the slowest growing in Scotland (see Figure 1).

This is a particularly worrying performance with respect to expressed Government views on matching UK growth by 2011. On March 3rd John Swinney stated that *“tourism is central to our aim of increased sustainable economic growth”*. One

would expect the greatest contribution of tourism to be in the Hotels and Catering sector and yet this is by far the slowest growing service sector in Scotland.

Figure 2: Transport, storage & communications



TRANSPORT, STORAGE AND COMMUNICATIONS (7%)

The biggest Scottish success story over the past year (Figure 2) has been in this sector, rising by almost 10%. This has been in turn driven by a very large increase in Communications (+15%) and which grew by almost 3% in Q4 alone.

Communications is the largely unheralded success story of recent Scottish growth, up over 162% on its 1998 level. This is well above the growth rate of Banking in Scotland for the same period and over three times the UK growth rate in Communications. However, it is not exactly clear where this relative Scottish success emanates from.

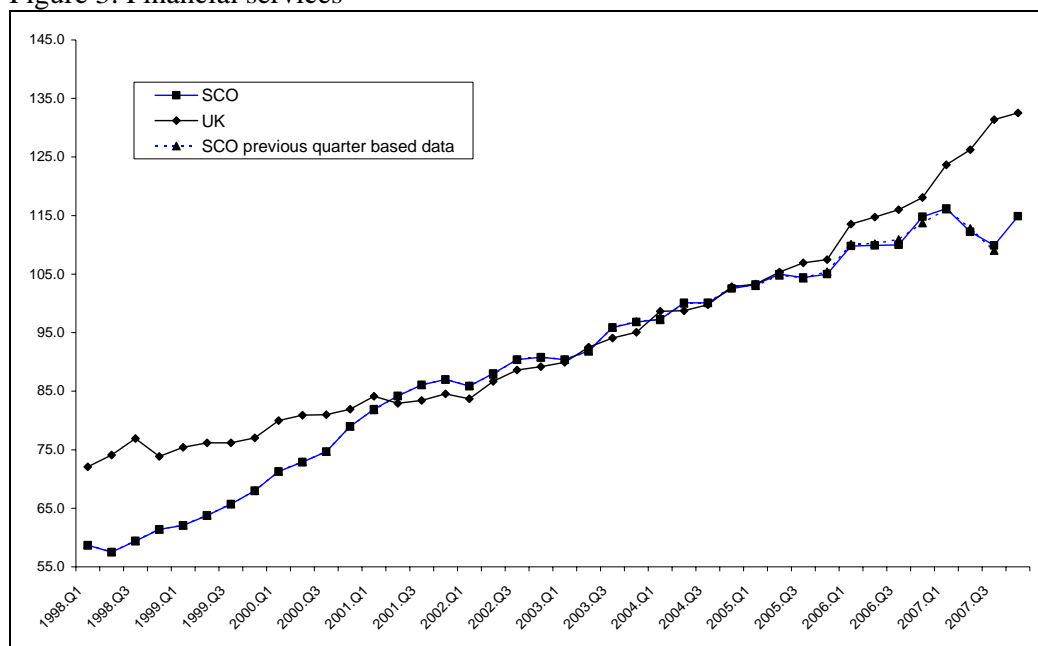
FINANCIAL SERVICES (8%)

After the recent bad news, where Financial services fell for two consecutive quarters, Q4 saw a substantial bounce back. However, since 2004 Financial services in the UK has still grown twice as fast as in Scotland. This after a period (1998-2001) where Scotland significantly outgrew the UK (Figure 3).

Financial Services is both a very important sector for the Scottish economy but also one where it is difficult to collect good statistical information for two reasons. First, because the profits/output associated with such Financial Services can be difficult to

measure. Second, because it can then be difficult to apportion these profits between countries, especially within the UK.

Figure 3: Financial services



CPPR will return to this sector in our next commentary to better understand its workings.

REAL ESTATE AND BUSINESS SERVICES (19%)

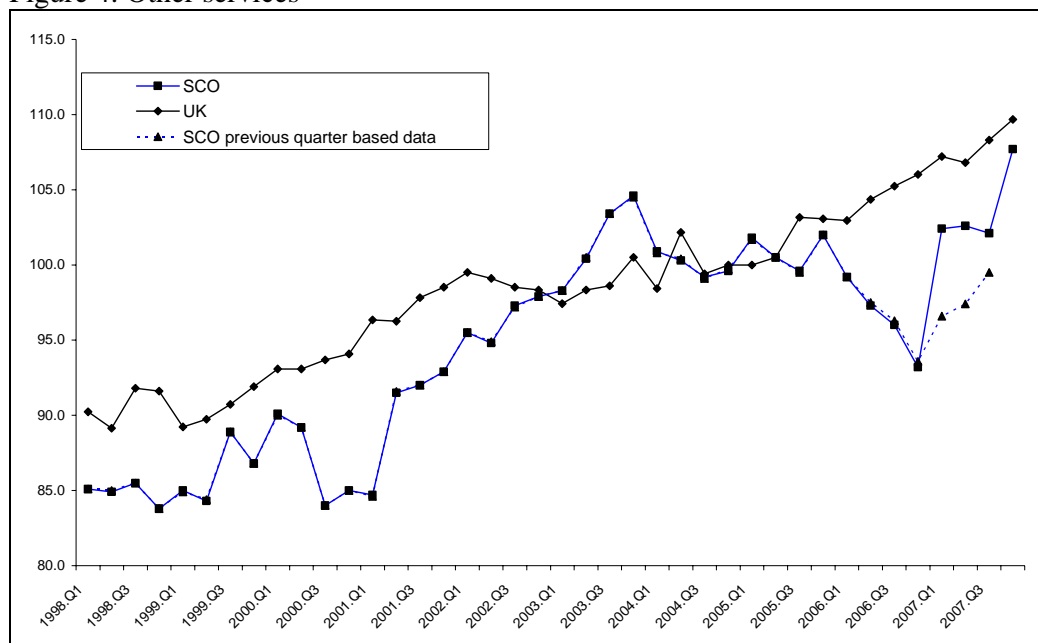
This sector continues to perform well for Scotland, growing by 4.4% in 2007. It has consistently been one of the biggest contributors to GVA growth since 1998. However, it is such a large sector (almost 20% of total GVA) that it would be useful to have it broken down in greater detail. For example, ONS data for the UK splits this sector into ‘Real estate, renting, and business activities’ and ‘Ownership of dwellings’. This would be a useful split to have for Scotland too.

PUBLIC ADMINISTRATION, EDUCATION AND HEALTH (23%)

This important sector performed poorly in 2007, up only 0.5%. When broken down (this breakdown is not shown in the publication but available from the Scottish Government), there has been a fall in both Public Administration and Defence (PAD) of 1% and in Education of almost 1%, offset by an increase of 2.7% in Health.

For the UK each of these three sub-sectors outperformed Scotland in 2007, PAD and Education were virtually unchanged while Health grew by 3.5%.

Figure 4: Other services



OTHER SERVICES (6%)

The worrying trend decline in Other services in Scotland since 2003 (Figure 4) was more than reversed in 2007. It is not clear what the source of this earlier decline might be.

The decline from 2003 to 2006 (which contrasted with the steady growth exhibited in the UK) was shared by the two principal components: Recreational, cultural and sporting activities; and Other service activities (including waste disposal). In both cases, but especially the former, such declines seem counter intuitive.

AGRICULTURE, FORESTRY AND FISHING (2%)

The past Scottish data for this sector has been substantially revised down so that GVA now falls by 6.7% in 2005 and remains around this low level in 2007. In contrast to this fall AFF in the UK has grown by over 8% since 2004.

THE PRODUCTION SECTOR (18%)

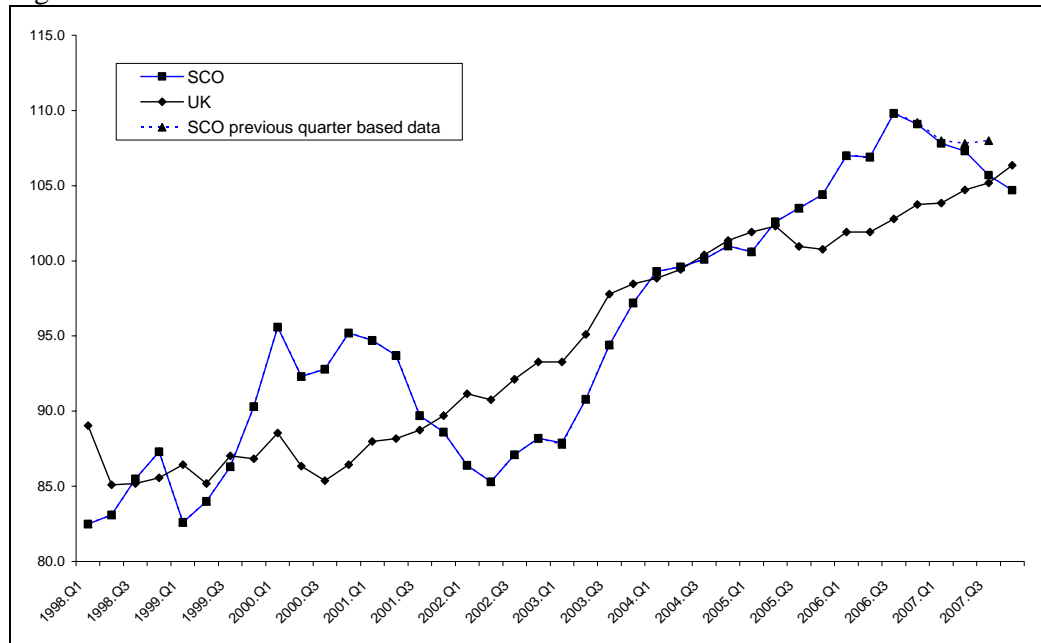
The production sector fell by 1% in Scotland in 2007, whereas in the UK it rose by 0.3%. However, the Scottish performance of this sector did not reflect the outturn of its principal component, Manufacturing. Manufacturing output rose by 0.9% but both Energy (-8.7%) and Mining industries (-6.7%) experienced large falls.

In the UK in 2007, Manufacturing and Mining were flat while Energy grew by 2.8%

Within Manufacturing, Mechanical Engineering had its best year in over a decade, growing by 9.3%. Although GVA for Electrical and Instrument Engineering fell again year on year, Q4 saw a 6% rise.

The performance of the Drinks sector is also interesting, especially in light of concerns for the whisky industry in Scotland post Budget. Drinks contribution to GVA has grown in 2006 and 2007 but was stagnant for the previous seven years. It would be interesting to know more about the areas affected (spirits, bottled water, other drinks?) and the causes for such a patchy performance.

Figure 5: Construction



THE CONSTRUCTION SECTOR (7%)

After outgrowing the UK sector from 2002 to 2006 (25% vs 12%) Scotland's Construction industry has fallen in each of the last five quarters (Figure 5), while the Construction sector in the UK has risen in each of the last 5 quarters.

This leaves a rather confusing picture of the housing sector with output declining in Scotland vs the UK but house prices holding up better in Scotland.

IMPORTANCE AND RELIABILITY OF GDP STATISTICS FOR SCOTLAND

The importance of GDP in measuring success for Scotland has been heightened since the new Government took over in May 2007. Not only is it the first, and arguably most important, target in the Government Economic Strategy, it is also the touchstone of success in their pronouncements on Government performance. For example, in the Foreword of the Government Economic Strategy the First Minister states– *“The purpose of the Government I lead is to create a more successful country...through increasing sustainable economic growth”*.

However, given the importance of measuring this success it would appear that the current data available is less than satisfactory. This view is based on a number of concerns.

- First, the Office for National Statistics (ONS) Economic and Labour Market Review (ELMR), publishes a quarterly article on Regional Economic Indicators. **The latest edition, February 2008, shows that according to Regional Accounts (RA) data for GVA at current basic prices Scotland outgrew the UK economy for each of the last three years for which data is available (2004-2006).** This higher growth rate would have been surprising even in terms of GVA per capita, and even if it had been by a very small margin but for the last two years (2005, 2006) the absolute Scottish growth rate was over 0.5 of a percentage point higher in Scotland than for the UK. Clearly these figures contradict the growth findings taken from the GVA volume measures at basic prices used in the Scottish Government quarterly publication, where in each of these three years the UK has outgrown Scotland. (Note: we accept that the two measures come from different sources and may exhibit slightly different findings but for such a sustained difference in relative performance to appear is very worrying. It is also worth noting that while the quarterly GVA data is used to measure the GVA Government target, the Regional Accounts GVA data is used to measure the Scottish Governments productivity target.)

Table 2: annual growth rates (%) 2004-2006

	2004		2005		2006	
	Sc	UK	Sc	UK	Sc	UK
GVA constant prices, 2004 base	2.7	3.5	1.7	2.1	2.8	3.2
RA GVA current prices	6.1	6.0	4.7	4.1	5.9	5.1

Footnotes:

1. all GVA measures above exclude extraction of mineral oil and natural gas
 2. Regional Accounts figures shown here are unsmoothed, as shown in EMLR
- Second, the Regional Accounts figures are currently being overhauled so that a breakdown by industry was not available in the latest publication. However, based on the previous publication of such a breakdown much work is needed. To take one example – according to Regional Accounts data GVA from Financial Intermediation in Scotland rose from £3.5 billion in 2001 to £5.2 billion in 2002, an increase of 49% in one year. (Note: broken down further the increase was seen to be in Eastern Scotland (i.e. Edinburgh) where GVA rose by 66% in that one year. It is not known whether or not this is related to

either the RBOS takeover of NatWest in early 2000 or the merger of Halifax and BOS in 2001.) Clearly there is something wrong here and yet the Input-Output tables for Scotland for 2004 concur with the Regional Accounts data for Scotland, including for Financial Intermediation.

- Third, there is the issue of the continuing concerns over some of the current GVA series, as alluded to above.
- Fourth, the sources and quality of the data has changed since its 1963 start point and this should be reflected in the figures, so that different 'quality' tags might be associated with different years. This is particularly relevant given the prominence often given to long run growth trends.

In our previous commentary of the quarterly Scottish GVA data we stated that in light of the Scottish Governments **new economic targets** more resources are needed in order to acquire a better understanding of the GVA data and trends and of the reasons why certain industry sectors perform like they do. Given the confusion alluded to above we now believe that this is most urgently needed. Indeed, given the importance accorded by the Government to the growth in GDP/GVA, the time now seems opportune for a comprehensive review of the relevant data for Scotland.

CONCLUSION

The latest GVA publication for Scotland continues to exhibit some worrying and often unexplained trends. In a number of sectors it is difficult to fathom the economic explanation for past and current movements.

We repeat our plea from the last commentary that more resources are needed in order to acquire more understanding. If judgements are to be made based on whether we succeed or fail to meet targets then such targets need to be reliably measured. For this reason we believe that the time will surely come when there will need to be a comprehensive review of the data used to measure Scottish economic growth.

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