The Future of Manufacturing Industry in Scotland
STUC Discussion Paper

The Future of Manufacturing Industry in Scotland

Executive Summary

This paper is the second in a series published by the STUC on aspects of the Scottish economy. It focuses on manufacturing industry, once the proud centerpiece of the Scottish economy but now struggling to adapt to the challenges of globalisation.

The STUC firmly believes that manufacturing industry in Scotland can have a positive future. As a minimum, the aim of public policy must now be to stabilise the manufacturing sector in Scotland in order to safeguard the jobs of the 225,000 people it currently employs. Growing the manufacturing base in the long-term is both achievable and desirable. The aspiration driving policy should be the creation of a sustainable, balanced economy benefiting from successful world class service industries and a re-invigorated manufacturing sector.

The following recommendations are set out in the paper:

On Skills and productivity

- A Scottish Skills Strategy should be developed with implementation overseen by a Scottish Skills Forum;
- Government at all levels to examine ways in which the public sector might develop workplace development programmes along the lines of our European competitors;
- The Scottish Manufacturing Advisory Service should be expanded; and,
- Workforce development and business support should remain the responsibility of the same agency in order to maximise efficient use of skills investments.

On Investment

- The STUC believes that the Scottish Executive should establish a Scottish Investment Bank (SIB) to overcome market failure and stimulate new investment from existing financial institutions.

On Public Procurement

- The UK and Scottish administrations must build on the work already underway to ensure that procurement policy supports indigenous manufacturing as far as is practicable under EU law;
- Specifically, both administrations should further develop strategies to support Remploy and sustainable procurement; and,
- The Scottish Executive’s Procurement Directorate should work proactively with priority industry teams at Scottish Enterprise to identify opportunities, and where appropriate, develop procurement strategies.
On Maximising Opportunities

- Ministers must work with social partners to produce and implement a modern industrial strategy for Scotland, a key aim of which will be to ensure that employment opportunities are maximised in new and developing sectors; and,
- State aid to manufacturing should be increased to match the EU average and targeted at Scotland’s priority industries in which we already enjoy comparative advantage.

On Monetary Policy

- The state of manufacturing industry to be taken into account in the remit of the Bank of England Monetary Policy Committee when setting UK interest rates – and for the MPC to include people with understanding and experience of industry.

On Selling Scottish manufacturing

- SDI to focus on improving the rate of Scottish manufactured exports; and,
- Increased support, through SMAS or enterprise networks for Scottish manufacturers to develop export strategies; and,
- EU to implement new regulations allowing producers of origin sensitive products to realise the benefits associated with Scottish production.
- Employers must address the poor employment practices and low pay that persists in some manufacturing sub-sectors; and,
- Politicians and the media must do more to celebrate Scottish manufacturing success stories.

On Energy

- A balanced energy policy for Scotland is required, one that is based on a diversity of fuel sources in order to ensure security of supply. We should aim to produce an energy surplus to export, recognising the importance of the industry in providing high quality jobs; and,
- The wider economic impacts of energy policy cannot be overlooked any longer. We must not repeat the story of UK innovation leading to manufacturing gain elsewhere due to lack of investment.

On Ownership

- Ministers to promote the positive benefits of Scottish ownership of industry;
- Ministers to address the lack of a level playing field at EU and WTO level; and,
- CDS to receive more support and resources.

On Employment Protection

- The UK Government must look at enhancing the rights of UK employees to be informed and consulted about company business strategies and to tighten redundancy regulation.
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Introduction

Recent redundancies at NCR in Dundee and Simclar in Ayrshire, and fears over the future of Weir Pumps in Cathcart, have served to highlight the ongoing fragility of manufacturing employment in Scotland today. On a more positive note, impressive new investment at Diageo and encouraging export statistics suggest all is far from lost.

The STUC’s primary concern is that, at a time when globalisation is placing manufacturing in all developed countries under pressure, some competitor nations are proving far more adept at retaining manufacturing jobs. This is the case even in countries where the regulatory regime is more robust and business taxation higher. Of course, what these countries tend to have in common is a higher rate of productivity per hour worked and a superior record of investing in people, plant, infrastructure and research.

This suggests that those who propose a future for Scottish manufacturing based on cost minimisation rather than productivity augmentation have got it wrong. We will not safeguard Scottish manufacturing by privatising the water industry\(^1\) or slashing protection for workers, consumers and the environment. Business conditions are generally good and have been for a decade. The disappointment is that too few companies have taken advantage of the stable conditions to invest.

The STUC believes government has a pivotal role to play in ensuring that Scotland’s manufacturing base is stabilised and nurtured. Government support and intervention should include passive measures such as tax credits for research and development and, in certain circumstances, direct assistance where companies with demonstrable long-term futures are facing short-term difficulty.

It is time for a mature discussion about the future of Scottish manufacturing. This must involve an informed and balanced appraisal of the challenges of globalisation and the level, nature and effectiveness of government support required to meet these challenges effectively.

Where we are

Statistics

In Scotland, manufacturing industry provides employment for 225,000 people, down 8000 on a year earlier\(^2\). The Scottish Economic Report\(^3\) published in December 2007 noted that ‘despite recent difficulties, Scotland’s manufacturing sector still plays a significant role in the Scottish economy. The sector accounts for 15.1 per cent of GVA, 10 per cent of total employment, and around 70 per cent of total exports (our emphasis)\(^4\).

From an export perspective, the most recent data show manufacturing exports growing by 2.2% in real terms in 2006 Q4 and by 3.2% over the year to 2006 Q4\(^4\) were up 1.3 per cent over the year to 2006 Q2.

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\(^1\) The standard response of the Scottish Conservatives to any job losses in manufacturing.
This follows the first annual increase for five years in quarter 3 2006. However, the value of Scotland’s manufactured exports in 2006 Q2 was just 67 per cent of the level in 2000\(^5\).

The SER also reports manufacturing investment, as measured by Net Capital Expenditure (NCE), falling for a fifth consecutive year. It currently stands at £782 million having fallen by around 55 per cent in real terms since 2000. This fall is partly explained by the very high levels of capital investment by electronics companies in the mid-nineties and the subsequent decrease in investment during the last few years as a result of the global downturn in the sector. In total, electronics accounts for over half of the decline in manufacturing NCE between 2000 and 2004\(^6\).

**Why is manufacturing important?**

In its current operating plan, Scottish Enterprise identifies 6 *priority industries* in which Scotland has clear comparative advantage: energy, food and drink, life sciences, tourism, electronic markets and financial services. *Distinctive strengths* are noted in enabling technologies and advanced engineering. *Regional priorities* include textiles, aerospace, shipbuilding and marine and chemicals. The list clearly demonstrates the ongoing importance of manufacturing industries to the Scottish economy and, importantly, the opportunities that exist to grow manufacturing employment.

Also, success in the services sector is not fully compensating for the decline in manufacturing. Trade figures for last year show that the UK had a goods deficit of £84.3bn, the biggest, as a percentage of GDP, for more than 60 years, while the services surplus was only £28.5bn.

An estimated 93,000 jobs in non-manufacturing industries are related to the manufacturing sector’s purchases\(^7\).

Manufacturing provides well-paid employment, a sizeable proportion of which is based in fragile rural or semi rural economies. Surveys consistently reveal the unfortunate truth that those made redundant from manufacturing tend to be re-employed in lower wage jobs\(^8\).

**Globalisation**

There is a danger that manufacturing in Scotland, and indeed the UK, could soon lose critical mass. Manufacturing has a poor public image with fewer and fewer young people regarding it as a positive career choice.

Trade unions are painfully aware of the challenges posed by globalisation. However, the bulk of the low skill assembly jobs particularly exposed to low wage competition have already been lost, often with brutal consequences for the workers involved. The casual dismissal of all lower value added manufacturing jobs by politicians and media commentators is a knee jerk, insubstantial response to globalisation. Clearly there will be instances when Scottish jobs are difficult to defend in the face of low wage competition but it is the STUC’s view that some low value added manufacturing sectors (i.e. food and drink) will increasingly be able to derive premiums from local production. Climate change will increasingly challenge current orthodoxy that it is always desirable to produce in countries with low environmental and employment standards.

\(^5\) Scottish Economic Report December 2006

\(^6\) It should be noted that electronics remains Scotland’s biggest manufacturing export sector.

\(^7\) Nurturing Wealth Creation, the report of the Scottish Executive’s Manufacturing Steering Group http://www.scotland.gov.uk/Publications/2003/02/16414/18386

The STUC believes that, as a minimum, the aim of public policy must now be to stabilise the manufacturing sector in Scotland in order to safeguard the jobs of the 225,000 people it currently employs. Growing the manufacturing base in the longer-term is both achievable and desirable. The aspiration driving policy should be the creation of a sustainable, balanced economy benefiting from successful world class service industries and a re-invigorated manufacturing sector.

The STUC is concerned that a relaxed attitude is developing within public sector agencies over the outsourcing of manufacturing jobs. The emerging orthodoxy is that it is a legitimate activity of publicly funded agencies to support businesses outsourcing manufacturing jobs should commitments be made to retain HQ functions in Scotland. It is the STUC’s considered view that such advice and support should only ever be offered on the basis of the most rigorous business plan and after every attempt has been made to ensure that the enterprise has become as productive as it can be with manufacturing based in Scotland.

If sourcing abroad is regarded as the employer’s only option, workers must be fully informed and consulted throughout the process and local PACE teams alerted at the earliest opportunity. The process must be managed sensitively. Opportunities to sustain Scottish jobs and business functions must be maximised. If not, the consequences will stretch far beyond the workplace concerned, reflecting poorly on the industry as a whole.

**Experience elsewhere**

The STUC believes that Scottish manufacturing has a viable future. In this context it is worth noting that other European countries, in respect of retaining manufacturing jobs, are coping far better with global competition as demonstrated in the table below:

<table>
<thead>
<tr>
<th>Member state</th>
<th>Manufacturing jobs Q2 2005 (000s)</th>
<th>Manufacturing jobs Q2 2006 (000s)</th>
<th>Change on year</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>3716</td>
<td>3663.8</td>
<td>- 52.2</td>
</tr>
<tr>
<td>Ireland</td>
<td>272</td>
<td>266.5</td>
<td>- 5.5</td>
</tr>
<tr>
<td>France</td>
<td>4041</td>
<td>4040.3</td>
<td>- 0.7</td>
</tr>
<tr>
<td>Finland</td>
<td>444</td>
<td>443.9</td>
<td>- 0.1</td>
</tr>
<tr>
<td>Germany</td>
<td>7939</td>
<td>8139.4</td>
<td>+ 196</td>
</tr>
<tr>
<td>Austria</td>
<td>704</td>
<td>727.4</td>
<td>+ 23.4</td>
</tr>
<tr>
<td>Italy</td>
<td>4797</td>
<td>4808.3</td>
<td>+ 11.3</td>
</tr>
<tr>
<td>Belgium</td>
<td>716</td>
<td>718.5</td>
<td>+ 2.5</td>
</tr>
<tr>
<td>Sweden</td>
<td>662</td>
<td>664</td>
<td>+ 2</td>
</tr>
</tbody>
</table>

(source – Eurostat)
A recent CPPR report examined the comparative position on employment and growth in a range of Western Europe’s Old Industrial Regions (OIRs). It found that:

“...the poorer performance of UK OIRs compared to the German OIRs, in terms of creating manufacturing jobs in particular, arguably raises the most interesting set of issues. Given the German economy’s widely publicised problems of high unemployment, the difficulties in handling the unification process and its greater proximity to Eastern European accession states, we might have expected a much greater decline in employment in its OIRs. Yet, with the exception of low-tech manufacturing – where performance is still better than that of the UK – the picture appears to be one of relatively successful adjustment during this period”

It is surely incumbent on policy makers to study the ways in which competitor countries support and enhance their manufacturing sectors with a view to learning from their successes. The STUC would encourage them to focus on the following areas:

1  Productivity and skills

“An analysis of manufacturing firms has shown the most productive firms are around 5.3 times as productive as less productive firms and that this variation in productivity is not explained by different productivity levels in manufacturing sub-sectors. The differentials also persist within individual sub-sectors”

Scotland must aim to increase the productivity of our manufacturing workplaces to the level of the world productivity leaders in northern and Western Europe.

The STUC believes that the current economic development framework at both Scottish and UK level is insufficient to meet this challenge.

The policy framework for economic development in Scotland (Framework for Economic Development in Scotland and A Smart, Successful Scotland) correctly identifies improving the rate of productivity in the public and private sectors as the key economic challenge. This mirrors policy outlined in recent Budget reports. However, it is doubtful that the policy prescriptions contained in these documents will ever be sufficient to improve productivity to the levels of our main competitors.

Scotland’s productivity challenge

Two measures of labour productivity are commonly used: GDP per worker and GDP per hour worked. The 2006 Pre Budget Report (PBR) attempted to show that the UK is winning the battle to close the productivity gap by focusing on the GDP per worker figures. GDP per hour worked figures that show the gap has barely closed over the last 10 years are glossed over.

However, GDP per hour worked is generally accepted as the better guide to relative performance because it excludes the effects caused by differences in working hours. The ‘positive’ story outlined in the PBR is explained by UK workers working longer hours, taking less holidays and toiling in jobs that have intensified.

The measuring Progress towards a Smart, Successful Scotland: 2006 report confirms the lack of progress achieved to date:

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9 Divergent Pathways in Europe’s Old Industrial Regions, Cumbers and Birch, CPPR, University of Glasgow 2006 http://www.cppr.ac.uk/media/media_7325_en.doc
10 Nurturing Wealth Creation, the report of the Scottish Executive’s Manufacturing Steering Group
11 Measuring Progress Towards A Smart, Successful Scotland 2006, the Scottish Executive http://www.scotland.gov.uk/Publications/2006/12/19161336/0
In 2004, Scotland was ranked in the second quartile of OECD nations; GDP per hour worked in Scotland has showed little change relative to the UK or the United States between 1999 and 2004 (note: it is interesting that the report chooses to specifically highlight Scotland’s performance against the United States. Data included elsewhere in the report shows that GDP per hour worked is actually higher in Norway, Belgium and France); and

To reach the top quartile, GDP per hour worked would have to increase by 7 percentage points.

Skills

There is a broad consensus that major deficiencies in skills are hampering efforts in Scotland and across the UK to improve productivity and competitiveness and to address key social justice issues such as reducing poverty, increasing social mobility and promoting equality. There is also general agreement that skills will become even more important in the future as global, demographic and technological change places an even greater premium on a highly skilled workforce.

That said, investment in skills alone will not transform our economic and social prospects. Skills require to be used properly. Skills policy needs to be integrated within the wider economic development policy framework and if productivity is to improve, greater investment in skills needs to be accompanied by greater investment in plant and equipment, in infrastructure and in research and development and more progressive approaches to work organisation.

To be successful, investment in workforce skills, by government and employers, must be part of a wider commitment to fair employment practice, including the full involvement of employees, through their unions, in workplace decision-making.

It is evident, however, that more investment in skills is required. Over a third of employers admit to not providing any training at all and two fifths of the workforce says they have not received any training over the past year. Analysing current skills levels in the UK, the Leitch Review concluded in its interim report that ‘the scale of the challenge [on skills] is daunting’ and that the ‘UK must raise its game’ to a significant extent.

The STUC is campaigning for:

- **A Skills Strategy for Scotland**, set in the context of the Executive’s Framework for Economic Development and Smart Successful Scotland, with the unions and other social partners fully involved in its creation and implementation, would enable a consensus to be achieved on priorities; roles and responsibilities, particularly in relation to investment; the skills profile we require; and the institutional infrastructure necessary to support it.

- The implementation of the Skills Strategy for Scotland should be overseen by **A Scottish Skills Forum** consisting of representatives of social partners and key stakeholders. It should be chaired by a Cabinet Minister and should be of a manageable size.
Utilising skills

However, it is also crucially important to emphasise that although investing in skills is a necessary condition for higher productivity, it is by no means sufficient.

In the past, the UK’s productivity gap with competitors was blamed on poor industrial relations but, whilst this was never a compelling analysis, it no longer has a shred of credibility. Instead, employers and media commentators look to blame poorly skilled workers, a declining work ethic, over regulation and deficiencies in the school education system for the failure to improve productivity.

Of course, these explanations conveniently omit any reference to the effectiveness of employers in deploying their resources productively. Meanwhile, policy interventions continue to focus on increasing the stock of skills whilst ignoring the ability of employers to utilise new or higher skills effectively.

Unfortunately, all too often the pressure on companies to deliver short-term efficiencies prevents the adoption of the kind of practices required to become more productive in the longer-term. For instance, under-staffing and work-intensification, often the result of the need to boost short-term gains, limit the opportunities for effective staff training.

The results are as inevitable as they are disappointing. As Mayhew and Keep (2006)12 point out:

“If organisations, sectors, or indeed, an entire economy reduce their systemic capacity to replicate the skills they need to sustain and improve production of goods and services, the cumulative long-term consequences are liable to be serious. The most likely outcome is a transfer of responsibility and hence of cost, from the employer to the public purse”.

The authors continue:

“While it may seem a statement of the blindingly obvious that having upskilled the workforce it will be essential to ensure that their jobs are redesigned in order to allow their new-found skills to be deployed to maximum productive effect, the fact is that while there are numerous expensive public programmes aimed at enhancing the skills of the future and existing workforce, there is no parallel effort aimed at bringing about work organisation and job redesign. Despite much talk about the need to ‘work smarter’ a realisation of what this might mean, and what might be needed to help make it a reality seems absent”.

The authors go on to note that the UK is unusual in taking such an approach. How work is organised is widely recognised as an important issue in a number of other European countries, where state-sponsored workplace development programmes have emerged in the pursuit of enhanced productivity and improvements in the quality of working life. Countries that have adopted such an approach include Norway, Sweden, Germany, Finland and Ireland.

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The recently established Scottish Manufacturing Advisory Service (SMAS) is a welcome development in this respect and its early performance in helping manufacturing companies boost productivity is impressive. The STUC is keen to see this early success built on through a substantial increase in the resources available to SMAS and major Ministerial investment in boosting its profile and influence.

Skills and productivity - recommendations

- A Scottish Skills Strategy should be developed with implementation overseen by a Scottish Skills Forum;
- Government at all levels to examine ways in which the public sector might develop workplace development programmes along the lines of our European competitors;
- The Scottish Manufacturing Advisory Service should be better supported and expanded; and,
- Workforce development and business support should remain the responsibility of the same agency in order to maximise efficient use of skills investments.

2 Investment

Academic studies identify skills deficiencies as accounting for only between a fifth and an eighth of the UK’s relative productivity gap with France and Germany. Skills do not appear to account for the skills gap with the USA at all.

Despite over a decade of macroeconomic stability, the Government’s own evidence suggests that UK companies fail to invest to the levels of our competitors.

The Government’s own analysis

The UK Government has identified five ‘drivers’ of productivity through which improvement occurs. The STUC believes these drivers have been arbitrarily chosen and represent only a partial account of the influences on productivity performance. However, it is instructive to assess performance against these drivers to date as reported in the DTI’s Productivity and Competitiveness Indicators 2006:

Business Investment: it is reasonable to assume that the macroeconomic stability maintained by the Government through the last decade would have provided firms with an ideal platform on which to invest. However, performance is disappointing:

“The indicators show that the UK has experienced a period of relative macroeconomic stability, compared to its competitors, as measured by the volatility of GDP growth and short-term interest rates, since 1998. However, this has not yet translated into a superior investment performance, as assessed by other investment indicators. UK business investment has averaged a lower proportion of GDP than France, Germany and the USA since 2000. …the UK’s relatively low investment over the last few decades means that the capital stock has a long way to go to catch up with the US, France and Germany”.

Innovation: the report extols the virtues of the UK’s science base but notes the lack of success at exploiting the benefits it provides:

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13 Ibid
14 DTI Economics paper no.17, UK Productivity and Competitiveness Indicators 2006
“The ratio of both total and business R&D expenditure to GDP has been consistently lower than in the US, France and Germany over the last decade. This gap may be partly explained by the UK’s sector mix, with the UK having more sectors with low intensity of R&D use. While R&D expenditure is an imperfect measure of innovation, it does provide a measure of the resources in the economy that are devoted to the generation of new knowledge”.

Scotland continues to lag behind in terms of R&D investment. The Scottish Executive’s January 2007 report on business research and development in Scotland reveals spending in 2005 was £584m, 0.59 per cent of GDP compared with 1.08 per cent for the UK. The Scottish Executive report notes that ‘the leading countries in terms of business R&D (in the EU) have expenditure levels more than four times higher than Scotland’.

Recent analysis suggests that the lack of R&D investment is attributable to the lower levels of retained profits in UK based firms caused primarily by higher dividend payments. The pressure for UK firms to deliver high returns within a very short timescale continues to seriously undermine prospects for long-term growth. It is widely recognised that the pressure on UK companies to deliver high returns over a very short timescales inhibits the kind of nurturing investment necessary to develop successful high-value manufacturing businesses in the longer-term. Many innovative Scottish owned and/or based companies also continue to struggle to find the investment needed to grow.

In his keynote speech to the third annual Business in the Parliament Conference on 3 November 2006, Nicol Stephen MSP, Deputy First Minister and Enterprise Minister discussed Scotland’s long-standing deficit on R&D spending before mentioning three examples of Scottish companies having to find investment elsewhere despite Scotland’s highly developed financial sector:

“The first is Pelamis – Ocean Power Delivery, our wave-power generating company and the first in the world at a commercial level. Its latest funding round, announced in the middle of the year, was £13m of new investment. How much of that came from the Scottish financial community? Out of £13m of new investment, £0.5m came from Scotland, and half of that was from the Scottish public sector. The second is Cyclacel in Dundee – a fantastic company with huge potential for the future. Its latest fundraising was through a flotation in the United States, achieved through a merger with a NASDAQ listed company. The third is Wavegen in Inverness, one of the great companies that has huge potential for the future. It is now owned by Voit Siemens.”

The Scottish Executive has undoubtedly recognised these problems and sought to act by introducing an array of R&D and co-investment support mechanisms. The question is whether the support currently available is sufficient in aggregate and targeted appropriately.

**Investment - Recommendations**

The STUC believes that the Scottish Executive should establish a **Scottish Investment Bank** (SIB) to overcome market failure and stimulate new investment from existing financial institutions.

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16 See Guardian articles
As a first step, this could bring existing support under a unified structure. A bigger impact could be made if a fully fledged industrial development and reconstruction bank were to be launched. A Scottish Investment Bank should:

- Provide grants, loans and equity to fill funding gaps;
- Assist in unlocking funds from private providers of capital; and,
- Tailor UK and European programmes to fit the Scottish needs and economic conditions.

The STUC proposes that the SIB’s services could be marketed and operated through the enterprise networks. Policy guidelines for the Bank should be set by a management board that reflects the diversity of the Scottish economy and recognises that sustainable economic development should aim to make Scotland a better place in which to live and work as well as a better place in which to do business. The board should therefore comprise the Scottish Executive, the enterprise networks, local authorities, trade unions and employers from both the financial community and manufacturing industry.

3 Maximising Opportunities

“Labour’s preternatural terror of being seen to “pick winners” has blinded it to the fact that other countries with far healthier manufacturing sectors have been busily nurturing their companies. The government has also missed the golden opportunity to secure first-mover advantage in the biggest growth sector of the next 50 years - environmental industries”.

Larry Elliot\(^{18}\) was writing about the Westminster government but, unfortunately, the same charge could legitimately be levelled at the Scottish Executive. The pressure on manufacturing means that it should be taken for granted that Government at all levels should seek to maximise the employment impact of existing sectors where Scotland already enjoys comparative advantage as well as new and developing industries.

In April 2004, the French Prime Minister, Jean Pierre Raffarin, said he was committed to a “truly European industrial policy”\(^{19}\). He added that France must play a strong role in a number of specific industries and had chosen nuclear energy, aerospace and health as strategic sectors.

Sweden has a particular focus on engineering. Germany, long time home of industrial engineering, is focusing on biotechnology. Wallonia in Belgium is in the centre of an automotive region that produces more than two million vehicles a year at 12 manufacturing sites, comprising General Motors, Ford, DaimlerChrysler, Renault, Nedcar, Toyota, Volkswagen and Volvo. Unsurprisingly, Wallonia’s regional government has offered investment incentives for motor companies seeking to locate there.

State Aid

The concept of state aid is easily misunderstood. The term ‘state aid’, whilst used by the European Commission to describe a particular type of assistance, can be portrayed, either by accident or design, as advocating a return to old-style interventionism, with the taxpayer propping up lame duck industries.

\(^{18}\) Larry Elliot, the Guardian

In fact, the EC position on state aid is one of common sense. Since government interventions should not be allowed to distort competition and intra-community trade, there is a general prohibition on state aid. However, as government interventions are deemed to be necessary in some circumstances for a well-functioning and equitable economy, there are exemptions. The trend in the EU, particularly in recent years, has been to try to reduce state aid, while recognising its value in limited circumstances.

Traditionally, the UK has given very low levels of state aid. Our state aid was the lowest among the EU15 in 2001. In recent years, this has changed slightly. Figures published by the European Commission in Spring 2005 showed that the share of aid given to manufacturing in the UK has more than doubled between 2001 and 2003\(^{20}\) (separate Scottish figures are not available).

Furthermore, the UK has risen from last place, when aid is measured as a proportion of value-added, to 12\(^{th}\) place, among the EU15. The STUC has consistently argued for levels of state support that match the European average. That hasn’t yet been achieved and we continue to seek progress on this issue, but the improvement is nevertheless to be welcomed.

The STUC believes that direct support should be available to help vulnerable companies within Scotland’s priority industry sectors to restructure or specialise. Seventy per cent of UK state aid goes to manufacturing, yet none of that is in the form of direct sectoral aid. It would only take a small proportion of aid to be directed at strategic industries in order to match the manufacturing strategies of France or Germany, whose manufacturing sectors are performing better than that of the UK.

We are consistently told that Scotland has a massive comparative advantage in renewable energy. This is undoubtedly the case. To renewables we would add that Scotland is particularly well placed to develop and manufacture clean coal, green transport and recycling technologies. We now require an effective strategy designed to turn comparative advantage into quality employment opportunities throughout the length and breadth of the country – but particularly in those fragile rural economies that stand to benefit most.

All the tools at Government’s disposal must be used strategically to this end: procurement, state aid and support for skills development, innovation and business growth.

The recent planning guidance introduced for renewable energy was a good example of the type of lever that modern government can pull. The following commitments contained in the draft SPP6 document:

- “The Scottish Ministers expect planning authorities to make positive provision for renewable energy developments by... ensuring that environmental, economic and social benefits are fully exploited”;
- “The scope for developments to contribute to local or national economic development priorities should be a material consideration when considering policies and decisions, particularly when local impacts can be satisfactorily mitigated”.

We look forward to the guidance being implemented in such a way that new developments start to use more local content.

\(^{20}\) State Aid Scoreboard, Spring 2005 update, European Commission.
Ministers must work with social partners to produce and implement a modern industrial strategy for Scotland, a key aim of which will be to ensure that employment opportunities are maximised in new and developing sectors; and,

- State aid to manufacturing should be increased to match the EU average.

4 Procurement

Public procurement in Scotland each year accounts for some £8bn of spending. The STUC’s aspiration for procurement policy is twofold:

- For procurement to play a pivotal role in securing the future of Scottish manufacturing. Trade unions recognise that public authorities must operate within tight EU competition rules but so far other countries have been far better at giving their manufacturers a slice of the public procurement cake; and,

- For procurement to be used to drive up standards across the economy. Contracts drawn up with suppliers and service providers can incorporate clauses on better employment standards, training provision, health and safety and environmental sustainability. There is great potential for procurement to help make Scotland a better place in which to live and work.

It is estimated that the public sector, including central and local government, together with bodies such as the Ministry of Defence and the National Health Service, spends £130 billion per year in the UK procuring goods and services and some £5bn in Scotland. The way in which this money is spent could be crucial to the long-term health of the UK’s manufacturing sector.

European rules dictate what can and cannot be done with regard to procurement. In general terms, it is illegal for Member States to discriminate against the goods and services of any other Member State in their purchasing decisions. In theory, providers of goods and services from any country should have the same chance of winning a procurement contract in any other country.

Whether this works in practice is another matter. In November 2004, the Wood Review, ‘Investigating UK business experiences of competing for public contracts in other EU countries’, was presented to the Chancellor.

This review, conducted by Alan Wood, Chief Executive of Siemens plc, reported that:

“Although we were asked to look in particular at the application of Single Market public procurement rules, it became clear from the consultation that ‘the rules’ in themselves (or their application) are not seen as the key problem. Few examples of discrimination in clear breach of Single Market public procurement law were provided for the Review. Most of these were anecdotal and difficult to substantiate…

“The problems are seen to be elsewhere, often described as ‘grey areas’ where Single Market rules are formally respected and yet national firms appear to be favoured.
“Many of the concerns expressed can be related to issues of industrial policy, including different approaches to state aid, market liberalisation and commitment to open competition.”

This appears to confirm the stereotype that the UK complies with European rules more strictly than our competitors.

‘Warlike’ Equipment

Exemptions to strict procurement guidelines do exist. For example, Article 296 of the Treaty of Rome states that “any Member State may take such measures as it considers necessary for the essential interests of its security which are connected with the production of or trade in arms, munitions and war material.”

Community rules do apply in principle to the defence sector. A derogation under Article 296 cannot apply to either civilian goods or to those not intended for specific military purposes, even if they are purchased by national defence ministries.

However, despite clarifications by the European Court of Justice, the low number of publications in the Official Journal of the European Union appears to imply that some Member States believe they can apply the derogation automatically. Since the concept of ‘essential interests of security’ is not defined either in Community Law or in the Case Law of the Court of Justice, in practice states allow themselves wide discretion in determining which contracts could damage them.

Battledress Procurement

An example from England is instructive. The issue of battledress procurement caused political controversy in December 2004 when a contract for military textiles, known as the ‘cut and sew tender’, was let to a company called Cooneen Watts and Stone. Companies based in Lancashire had delivered this contract for many years. Had they retained the contract, the high-tech element, the camouflage print and material, would have been made in Lancashire. Under the Cooneen Watts and Stone bid, that work would be subcontracted to China.

This contractual decision provoked an unusual degree of concern, with MPs from the North West vociferously expressing disappointment. This concern was based on factors including:

- Cooneen Watts and Stone bid for the contract, yet was not the company that would carry out the contract;
- The factory in China that would produce the textiles was quoted as paying rates of just over £1 per day. Textile manufacturing in China is carried out in violation of the ILO Core Labour Standards. No free trade unions are allowed in the Chinese factories; and,
- Many other EU countries classify military uniforms as ‘warlike’, which means they are not covered by EU procurement rules, for reasons of national security.

21 ‘Investigating UK business experiences of competing for public contracts in other EU countries’, Office of Government Commerce, paragraphs 1.2.1 – 1.2.3.
22 Treaty establishing the European Community, Article 296.
The decision to change the contractor for the 'cut and sew tender' was not reversed. The STUC believes the government at all levels should learn the lessons of this decision and support its manufacturing workers in the same way as competitor countries do.

Similarly, the Military Afloat Reach and Sustainability (MARS) project is a high-profile MoD programme that will be providing logistical support to Royal Navy vessels. The project is now at the end of the concept phase and orders will be placed over the coming years. Trade unions have expressed concern that the MoD will not class the order for these vessels as ‘warlike’, thereby opening it to Europe-wide tendering.

An MoD order in 2000 for four Roll On-Roll Off ferries was similarly not classed as ‘warlike’, was tendered across Europe and was won by a German shipyard, at the expense of UK shipyards and UK jobs. This is contrary to the practices of other European states, which tend to use the ‘warlike’ provision in support of their own shipbuilding industries. The UK appears to be playing by a different set of rules to other European countries, resulting in our manufacturing capacity losing out.

This reflects recent experience in Scotland where the Scottish Executive has refused to classify fisheries protection vessels as ‘warlike’.

**Defence Industrial Strategy**

In December 2005, the Government published its Defence Industrial Strategy. Whilst this was a Ministry of Defence document, the fact that its foreword was signed by Ministers from the DTI and HM Treasury, as well as the MoD, suggested that a cross-cutting government agenda, based on the UK’s defence needs but also the needs of its industry and the economy, was being addressed.

The Defence Industrial Strategy provides for the transparency of our future defence requirements and sets out those industrial capabilities we need in the UK to ensure that we can continue to operate in the way we choose.

The clarity provided by the Defence Industrial Strategy seeks to promote a dynamic, sustainable and globally competitive defence manufacturing sector.

The strategy is also realistic, recognising that industry will have to reshape itself, to improve productivity and to adjust to lower production levels once current major equipment projects have been completed. However, in the words of the strategy, “by starting the process today, while workloads are high, we can avoid facing a crisis in a few years time.”

The Defence Industrial Strategy recognises that the UK defence market is the most open in the world. All US defence orders must contain at least a 60% US component, which effectively precludes manufacture outside the US, while our European partners tend to submit military and military support expenditure internally.

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The STUC recognises that the defence sector benefits from Article 296 of the Treaty of Rome, which exempts ‘warlike’ equipment from normal public procurement procedures. Nevertheless, there are principles here that would be valuable if introduced into procurement policy more generally. These include: making a link between the needs of government procurement and the importance of a manufacturing presence in certain key areas; identifying key sectors of manufacturing where Scotland is world-class, and using procurement policy to promote that sector as far as possible; and recognising future trends, acknowledging that orders will fall in some sectors in years to come and planning for that now, so that no surprises exist when that day arrives.

Furthermore, it is surely common sense to link the needs of industry with the benefits to the economy of having a strong industrial presence in certain areas. There is no reason why we could not develop a ‘healthcare’ industrial policy, or a ‘transport’ industrial policy, within EU rules. It is important to note that the Defence Industrial Strategy is not a crude ‘Buy British’ policy. Indeed, the strategy specifically notes that “We also recognise the attractions of the US market, given its scale and high levels of investment in research and technology”24.

There will be times when it is not in the interests of the MoD to buy British; but the Defence Industrial Strategy will help to maximise those occasions when it is.

Social Clauses in Procurement

A separate but related issue is that of social clauses in procurement. Under the new EU Public Procurement Directives, Member States are allowed to invite tenders for the provision of goods and services that include social, employment and environmental considerations. Recital 33 of the Directive lists some of the issues that might be addressed, which include “on-site vocational training, the employment of people experiencing particular difficulty in achieving integration, the fight against unemployment or the protection of the environment”.25

The STUC believes this clause can and should be used to provide orders to Remploy, provided that they are able to meet required standards. Such action would ensure that work is provided for the many disabled employees and potential employees of this laudable company. It would also be in line with the government’s policy of getting people back to work, especially those on long-term disability and incapacity benefit.

Some commentators argue that Scotland’s years as a manufacturing nation are behind us. The STUC could not disagree with this more strongly, but we do believe that our years of indulging manufacturing companies that do not train their workforce, do not seek to work in innovative ways and try to compete on the basis of ‘bargain basement’ terms and conditions are most certainly behind us.

By inviting tenders that require companies to skill their workforces properly, or that develop the talents of all their workers, male and female, young and old, black and white, public procurement can play a modest but important step in driving up standards in our manufacturing sector.

24 ibid, p. 6
25 2004/18/EC, Recital 33
The best manufacturing companies already behave in this way and have nothing to fear. If we are to succeed in the longer term, we must invest for the longer term.

**Sustainable public procurement – industrial opportunities**

Sustainable public procurement, intelligently applied and led by Government, offers the UK major new opportunities to develop the UK’s green manufacturing and service industries.

The UK Government’s *Sustainable Procurement Task Force’s National Action Plan* offers the UK a major opportunity not only to tackle the 20 million tonnes of CO2 emissions which is attributed to public procurement activities, but to stimulate a wide range of green manufacturing and service industries.

*Procuring the Future* identifies typical spend areas for procurement by all departmental groups, including: £6.5bn for office machinery and computers; £5.4bn on transport (cars and business travel); £4.2bn on IT Services; £3.2bn on food; and £1.7bn on pulp and paper.

The report cites a number of examples of governments already actively driving markets through public procurement, including successes in the US through the use of the Energy Star labelling scheme for computers. In Japan, a combination of policy tools that included legislation on green purchasing, sales of low emission vehicles have increased dramatically in recent years. For the national government the proportion of low-emission vehicles in its fleet has risen from under 20% in 2001 to 100% in 2005.

A similar view has emerged from *The Corporate Leaders Group on Climate Change*. Its recent submission to the Prime Minister offered a critical assessment of current public procurement strategies:

“Many promising low carbon technologies such as fuel cells and energy efficient LED lighting need further investment to bring down costs and enable them to be commercialised. R&D is relatively cheap and leads to many prototype products, but frequently these do not make it to market because the uncertainty of future sales makes it too risky to invest in the expense of demonstration products and scaling-up production. Private sector supply chain management techniques allow suppliers to make these investments by clearly articulating future needs and providing a credible promise of future sales. Public sector procurement currently fails badly in this respect [our emphasis] but has the potential to play a key role at little risk by using the forward commitment procurement techniques common in the private sector.”

Conceptually the process is simple: a government department or agency offers to buy in the future a product or service which delivers specified carbon emission benefits at a defined volume and at a cost that it can afford. Once the product is available in the market place, normal market forces will determine competition and price.

The Corporate Leaders Group also argued that the EU Emissions Trading Scheme (ETS) was critically important for providing a central signal to business about the rising cost of carbon.

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28 Corporate Leaders Group on Climate Change, July 2006.
But, “there is a need to introduce policies capable of triggering step-changes in technology development in areas such as carbon capture and storage, hydrogen storage, tidal and wave generation and new transport technologies.” The STUC supports these views, and has argued that the Scotland is in danger of missing opportunities to develop clean coal technologies, allied to carbon sequestration.

As currently drafted, the DTI’s approach to Phase II of the EU ETS will act as a disincentive to clean coal investments.

The STUC welcomes the initiative of the Corporate Leaders Group in encouraging Government to act on the recommendations of the Sustainable Procurement Task Force, on how the proactive management of public supply chains can bring innovative low carbon products and services to market. “Such action will create significant competitive advantages for the UK by helping to drive the commercialisation of low carbon products and services,” the group suggested.

Procuring the Future identifies several key challenges for public sector procurers – to lead by example, set clear priorities, and ensure that it builds capacity within the procurement professions – in order to achieve the radical environmental objectives set by Government. The STUC believes that, consistent with these environmental goals, sustainable public procurement offers major opportunities for UK manufacturing and services through an imaginative use of social clauses in procurement, allied to a creative approach to Article 3 of the Treaty of Rome.

Procurement – Recommendations

- The UK and Scottish administrations must build on the work already underway to ensure that procurement policy supports indigenous manufacturing as far as is practicable under EU law;
- Specifically, both administrations should further develop strategies to support Remploy and sustainable procurement; and,
- The Scottish Executive’s Procurement Directorate should work proactively with priority industry teams at Scottish Enterprise to identify opportunities, and where appropriate, develop procurement strategies.

5 Monetary Policy

An article in a recent Bank of England Quarterly Bulletin stated:

“The UK’s export market share has declined steadily for a number of years, both in aggregate and in many industries within the manufacturing sector. A major determinant of demand for an industry’s exports is the price of those exports relative to the prices of international competitors.”

Globalisation is normally blamed for the closure of factories and the export of production overseas, but the pound has been to blame too for eating into the ability of firms to invest. The latest profit figures show the extent of the problem.
Whilst the service sector, which is much less sensitive to the exchange rate, is enjoying a return on capital of more than 20%, the comparable figure for manufacturing is 10%\(^{30}\). Whilst industry’s record on investment is lamentable, the strong pound is undoubtedly a factor explaining the extent of under investment.

**Monetary Policy – Recommendation**

- The state of manufacturing industry to be taken into account in the remit of the Bank of England Monetary Policy Committee when setting UK interest rates – and for the MPC to include people with understanding and experience of industry.

6 Selling Scottish Manufacturing

**Exports**

There is a pressing need to rebalance trade with emerging economies. For example, between 2000-2003 Germany increased its exports to China by 93% but the equivalent UK figure was 17%\(^{31}\). There are some encouraging signs that Scotland is improving its performance in this area but there remains plenty of room for improvement.

However, trade issues have disadvantaged Scottish exporters in key areas such as whiskey and textiles. Whilst this has to be placed in the context of trade agreements which, overall, clearly disadvantage developing nations, it is not unreasonable to argue that EU imposed restrictions on labelling for instance should be dropped in order to allow Scottish companies to derive a premium from their location – this is absolutely essential if Scottish companies are to exploit niche markets.

**Exports – Recommendations**

- SDI to focus on improving the rate of Scottish manufactured exports; and,
- Increased support, through SMAS or enterprise networks for Scottish manufacturers to develop export strategies; and,
- EU to implement new regulations allowing producers of origin sensitive products to realise the benefits associated with Scottish production.

**Image**

There is little doubt that manufacturing industry currently suffers from a poor public image. This matters because manufacturing must attract new recruits with the necessary skills in order to sustain itself.

Trade unions are often accused of talking the prospects of manufacturing down. We resent this charge which reflects the media’s tendency to report union views only when redundancies have been announced or are in the offing. The STUC believes that much more detrimental to the image of manufacturing industry is the way in which redundancies and closures are often handled and the low pay and outdated command and control management approaches that remain too common in Scottish manufacturing.

There are currently a number of real success stories in Scottish manufacturing: world class companies fully consulting with their workforces to produce step-changes in productivity allowing them to succeed in competitive global markets. The success of these companies must be promoted both domestically and globally.

\(^{30}\) National Statistics Corporate Profitability A4 2006

\(^{31}\) EU Commission - no Scottish figures available
Image – Recommendations

- Employers must recognise the damage done to manufacturing when outsourcing is poorly handled. Redundancies must be handled more sensitively with earlier involvement of PACE – all alternatives to outsourcing/redundancies must be fully explored;
- Employers must address the poor employment practices and low pay that persists in some manufacturing sub-sectors; and,
- Politicians and the media must do more to celebrate Scottish manufacturing success stories.

7 Energy

We hear far too much hot air from employer representative organisations about levels of taxation and the high cost of regulation. Most of this is demonstrable nonsense. As reported by trade union organisers in the sector, high-energy costs were the main problem facing manufacturing over the past year.

The UK Government must grasp the opportunity provided by the Energy Review to fundamentally address the key issues of security of supply, affordability and climate change.

Energy – Recommendations

- A balanced energy policy for Scotland is required, one that is based on a diversity of fuel sources in order to ensure security of supply. We should aim to produce an energy surplus to export, recognising the importance of the industry in providing high quality jobs.
- The wider economic impacts of energy policy cannot be overlooked any longer. We must not repeat the story of UK innovation leading to manufacturing gain elsewhere due to lack of investment.

8 Ownership

On the back of Scottish Power’s sale to Spanish firm Iberdrola and the possible sale of Weir Pumps to Swiss firm Sulzar, the ownership of Scottish industry is a topical but fraught issue. Many commentators express concern when foreign companies buy out UK or Scottish businesses but any action that could possibly curtail this increasingly common process is casually dismissed as protectionism.

Few dispute that indigenous ownership provides benefits in terms of control and high quality HQ and research jobs. Scotland needs a mature debate about ownership of industry. The debate has to be informed not just by a full and proper understanding of the constraints on Government’s ability to act but also of the un-level playing field that exists whereby tax breaks are often available to foreign-based companies purchasing UK concerns.

Politically and psychologically, it is easier for foreign owners to cut jobs here than for British-based firms: if the HQ is elsewhere, jobs here are seen as peripheral. It is also practically easier to shed workers in the UK than in, say, France or Germany, where employment protection is much stronger.

32 See STUC discussion paper, Challenging the Red Tape Myths, December 2006
There are benefits in Scotland being a very open economy. But as long as the playing field remains uneven, we are likely to suffer from the loss of ownership. Other nations, including India, persist in erecting barriers to overseas investors. It would be helpful to know whether the UK and Scottish administrations believe any industries remain that would be considered too strategically important to pass out of domestic control?

The ‘Wimbledon’ theory of ownership states that the takeover of UK firms by foreign owners shouldn’t concern us as long as the business takes place in the UK. Wimbledon after all, is a successful British institution even although our players don’t win.

It can be argued that the theory holds true for the City. The fact that US and European banks have colonised the City with no discernible adverse impact is explicable by the special factors at play: the English language, a convenient time zone and a favourable tax regime. These do not apply to manufacturing industry.

Meanwhile there is positive action that can be undertaken to promote business models that have a higher chance of sustaining indigenous ownership. This is one of the main reasons the STUC supported the establishment of Co-operative Development Scotland.

However, we are less than assured that the organisation is receiving sufficient support or resources as part of the enterprise networks.

Ownership – Recommendations

- Ministers to promote the positive benefits of Scottish ownership of industry;
- Ministers to address the lack of a level playing field at EU and WTO level; and,
- CDS to receive more support and resources.

9 Employment Protection Legislation

Whenever jobs are lost in the UK, and trade unions point to the lack of a level playing field in terms of employment protection legislation, reactions are fierce. Commentators of all persuasions are quick to emphasise the futility of any strategy which seeks to enhance the employment rights of UK workers. The UK’s flexible labour market is, after all, the crowning glory of the UK economy.

Such a view wilfully misrepresents the trade union position. Trade Unions do not argue that simply enhancing employment rights is a sufficient response to globalisation. Rather, unions have emphasised EPL as part of a wider strategy that seeks to improve performance in all the areas listed above. Scotland’s manufacturing success stories are underpinned by constructive and innovative union/employer relationships.

However, politicians and media commentators have to understand that when jobs are lost in Scotland, management often point to the ease with which employees can be sacked relative to the continent. With this in mind, it should be pointed out that, to the best of the STUC’s knowledge, the following have never been provided to trade union representatives as reasons for redundancies: an uncompetitive tax regime, the regulatory ‘burden’ or the size of the public sector.
Also, the shocking way in which closures can happen in Scotland i.e. Simclar is not only bad for the individuals concerned, it reflects poorly on manufacturing as a whole. It exacerbates skills shortages.

- The UK Government must look at enhancing the rights of UK employees to be informed and consulted about company business strategies and to tighten redundancy regulation.

**Conclusion**

A positive agenda for Scottish manufacturing must address the failures listed above and seek to build on the practical assistance being delivered by the Scottish Manufacturing Advisory Service in Scotland.

It is not that long ago that manufacturing was regarded as the backbone of the economy; now there is a widespread feeling that it doesn’t matter much; we cannot compete with emerging nations and that services and the ‘knowledge economy’ are the way forward.

The STUC believes this is a complacent view and highly detrimental to Scotland’s long-term interests. Over 1500 jobs have been lost in manufacturing since the start of this year. True, employment is still strong overall, but it is unbalanced, with all the growth in the past few years having come from the public sector and the services sector. Scotland should be proud of its tremendous success in financial services but it is unlikely to console employees who have lost their jobs at NCR or Simclar.

There is also the question of the nature of the jobs being lost compared with those being created. Over 200,000 people still work in manufacturing; surveys show that workers made redundant from manufacturing are often forced to take on lower-level, lower-waged employment, with consequent loss of skills to the economy.

Scotland can no longer expect to compete on low value added manufacturing with lower-wage economies, but we can and should seek to grow our manufacturing industry on the basis of the recommendations outlined above. Manufacturing has declined as a proportion of the total economy but it remains a vital component of the Scottish economy. We cannot be complacent about its demise.