North Sea Oil and Manufacturing Output – Comment

Eduard J. Bomhoff*

John Kay claims that a significant part of the recent decline in British manufacturing output was the inevitable result of North Sea oil. In his view, the discovery of North Sea oil was bad news for British industry. He bases his argument on simple manipulation of input–output tables, but before we are carried away by the stark numbers in his Tables 33–35, we should pause for a moment to realise that this is a very strange message indeed.

How can a contraction of the manufacturing sector be ‘inevitable’ when on so many other occasions a resources boom led to increases in manufacturing and to higher economic growth? In the past, industry grew most rapidly in those areas of the United Kingdom where coal and other inputs were available. According to John Kay, coal mining in the Midlands should have led to greater output of tradeables (industrial output) in the south-east of England, and greater specialisation towards non-tradeables (hotels, symphony orchestras) in the coal mining areas. This scenario does not appear to be a useful description of what actually happened.

Similarly the boom in resource development that currently is under way in Australia should have dire consequences for industrial employment in that country, according to Kay’s input–output analysis. Brief quotations from two recent publications on the Australian economy show what the exploration of natural resources really means for a healthy economy.

*I am grateful to Mr Kenneth Waller, Minister (Treasury) at the Australian High Commission in London for supplying me with recent data on the Australian Economy.
Profitability has improved. Australia’s international competitiveness seems to have been restored to about where it was in the early 1970s. The strengthening of private sector activity over the past two years or so can be attributed in no small way to the general anti-inflationary thrust of the policies which have brought about these improvements and have helped, in so doing, to create a more favourable economic and investment climate. Changes in relative energy prices, which have favoured development of resources with which Australia is generously endowed, have also contributed to this economic recovery. These latter changes are in some respects fortuitous but the speed and vigour with which investors have moved to take advantage of Australia’s increased comparative advantage in the energy-related resource sector owes a good deal to steps having been taken earlier to re-establish the pre-conditions for a high level of investment, in resource and non-resource areas alike.

Government of Australia: Budget for 1981/82, statement nr. 2
The Budget and Economy, p. 45.

Common sense would suggest that manufacturing investment, in a world with sharply fluctuating relative prices for energy and political uncertainty in many energy-producing countries, would flow to countries that are fortunate enough to have secure energy supplies of their own. Australia, the United Kingdom, and Holland are such countries. If, therefore, investment in Australia increases according to the law of comparative advantage, whereas investment in the UK and Holland stagnates, then the sad experiences in the UK and Holland cannot be explained as the unavoidable consequences of energy production.

Hunter and Wood (1981) are optimistic about the future of Australia. (J. S. H. Hunter and J. C. Wood, ‘Australian resource development, in the 1980s’, Quarterly Review, National Westminster Bank (November 1981) 17–26). They expect continued growth of manufacturing industry in the period 1980–5, and foresee steady increases in exports of manufactured goods. The forecasts take into account a strengthening of Australia’s real exchange rate, but positive developments, such as continued rapid economic growth in the Asian–Pacific region, and Australia’s secure energy position compared to Japan, are thought to be more important. As regards employment, Hunter and Wood have this to say:

The indirect employment effects of the resources boom are likely to be