Briefing Note
Confronting the Productivity Challenge
LRI Roundtable

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Queen's University Belfast

Long Run Initiative

Directors: Dr Michael Aldous, Dr Laurence Mussio, and Professor John Turner
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LRI Productivity Roundtable

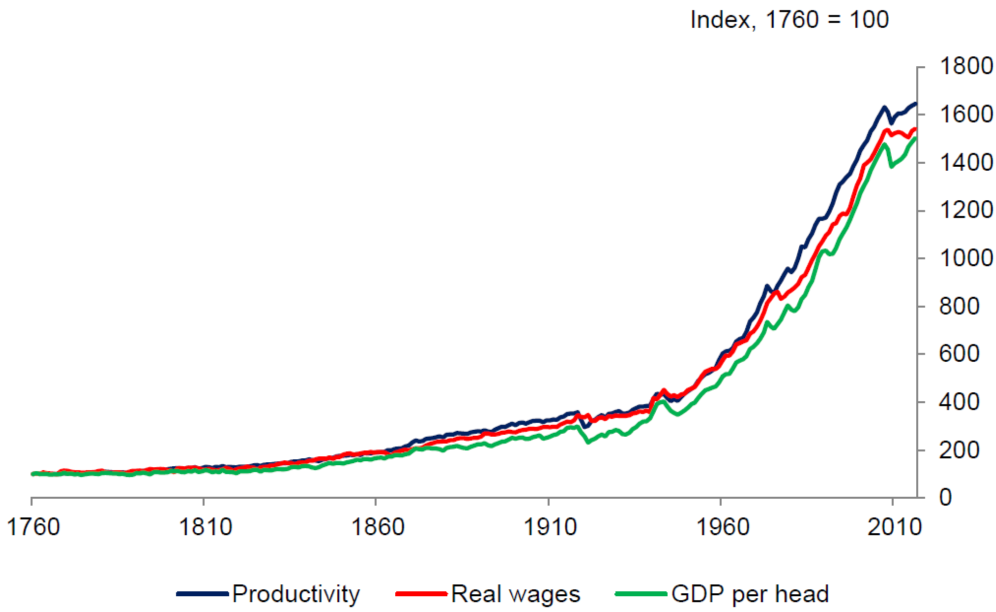
This document is a synopsis of the Long Run Initiative's Roundtable on Confronting the Productivity Challenge. The event brought experts and scholars together from academia, government and corporate sectors to discuss the theme of the day in front of an audience of over 60 participants. The proceedings were governed by the Chatham House Rule. Accordingly, this synopsis does not discuss the identities of those expressing opinions or perspectives.

Participants:
Diane Coyle (Bennett Professor of Public Policy, University of Cambridge)
Nick Crafts (Professor of Economics, University of Sussex)
Emma Flynn (Pro-Vice-Chancellor Research & Enterprise, Queen's University Belfast)
The Hon. Kevin Lynch (former Clerk of the Privy Council and Secretary to the Cabinet, Government of Canada)
Angela McGowan (Director of the Confederation of British Industry, Northern Ireland)
David Paulson (Professor of Practice, Queen's University Belfast)
John Turner (Professor of Finance and Financial History, Queen's University Belfast)

The Productivity Problem

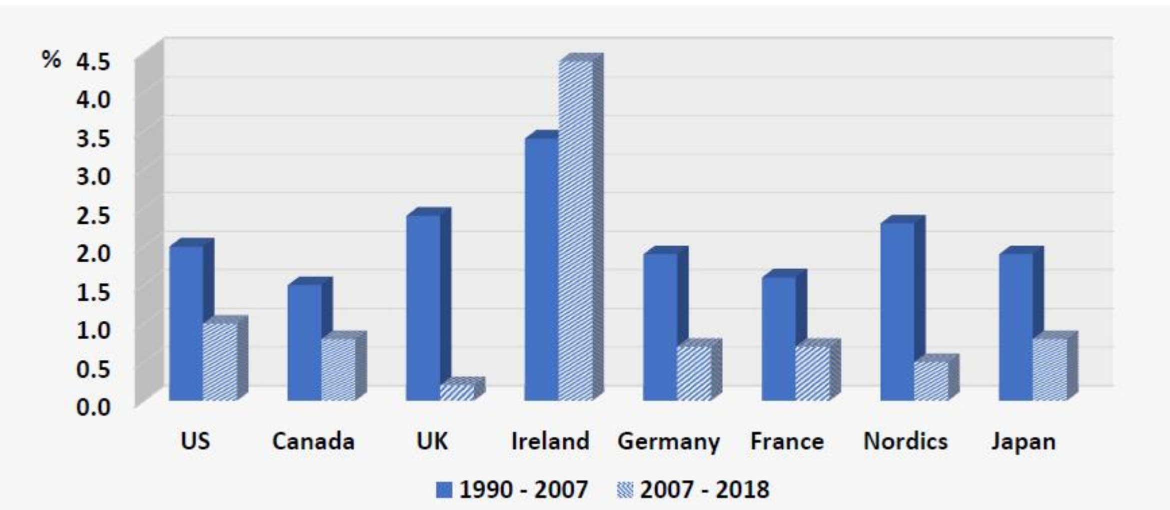
For 250 years, consistent improvements in productivity have created an engine for economic growth, greater prosperity and better standards of living. Since the Global Financial Crisis, that two-and-a-half century winning streak has stalled: productivity has flat-lined. A stalling productivity engine has major long-term consequences for the future of economic growth, prosperity and standards of living.

Figure 1: *UK labour productivity, real wages and GDP per head*



Source: Haldane, [*The UK's Productivity Problem: Hub No Spokes*]()

Figure 2: L*abour productivity (GDP per hour worked) before and after the financial crisis*



Source: https://www.oecd.org/global-forum-productivity/data/

How Big a Deal Is Stalling Productivity?

Andrew Haldane, *The UK's Productivity Problem: Hub No Spokes*: "The UK faces perhaps no greater challenge, economically and socially, than its productivity challenge."

Paul Krugman: "Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker."

Andrew Smithers, *Productivity and the Bonus Culture*: "Absent another financial crisis, poor productivity poses **the** major threat to the UK and US economies. It should therefore be our main economic preoccupation. But it isn't."

Unfortunately, the preoccupation with Brexit has distracted the energy and time of UK policymakers and businesses, with the result that the productivity challenge has been ignored. But is it the most pressing issue?

The roundtable concluded that there are equally pressing challenges facing the UK - climate change, the rapidly changing labour market and income inequality being three of these.

Why Has Productivity Slowed Down?

Reason 1: Technopessimism
Robert Gordon, an economist based at Northwestern University, argues that the economic revolution of 1870-1970 was unique in human history. There was an unrepeatable clustering of new inventions in this era. According to Gordon, the innovations of the past decade and a half have focussed on entertainment and are trivial - they have therefore not contributed to productivity. The roundtable dismissed Gordon's technopessimism by discussing the new technologies that have emerged in recent decades that have enhanced productivity, from complex production and distribution networks to the smartphone.

The roundtable moved on to discuss the puzzle of why technology changes haven't shown up in productivity numbers. Several possible explanations were discussed:

- Measurement – innovation is now ideas, which are difficult for statistical agencies to track, including difficulty of what consumers are purchasing/doing. Are we therefore measuring productivity correctly?
- If technological change is adjusted for, prices of services have fallen, and/or quality has improved, e.g., cheap, one-off innovations/products that can be 3D printed.

- Productivity might be a dead metaphor: are there other ways to understand progress? For example, time/speed of services in a service-based economy might be a better measure.

Reason 2: Turmoil
Uncertainty has significant role to play: uncertainty surrounding the Financial Crisis has morphed into geopolitical uncertainty (Brexit, Trump's trade war, the rise of populism etc). Firms are therefore not investing. This is particularly true of small firms. Structural uncertainty is acting a major drag on productivity growth.

In Northern Ireland, the uncertainty with Brexit and future trading relations with the EU and UK are having a major effect on both inward investment and investment by NI firms.

Reason 3: Temporary aberration
Taking a long-run view, there has been persistent labour productivity growth (with variation) since 1870. This makes 2007 onwards a massive outlier, with productivity 20% below trend. The only potential equivalent is the early 1970s, when the UK was 10% below trend.

Government policy has not got any worse in last 10 years, when taking into account labour quality. The last decade has seen a combination of events not previously seen. The economy has been badly disrupted by a combination of the Global Financial Crisis, Brexit and the waning impact of ICT, a general purpose technology.

The immediate past is not a good guide to the medium-term future: if uncertainty diminishes, and this is combined with new technology, we could return to productivity growth well above zero.

<u>What Can Be Done to Improve Productivity?</u>

Brexit

- For policymaking, Brexit doesn't in the end matter either way [positive or negative]: it is the issue of the quality of policymaking in Westminster which determines the productivity outcomes of concern; the constraints from Brussels do not matter.

Geography matters

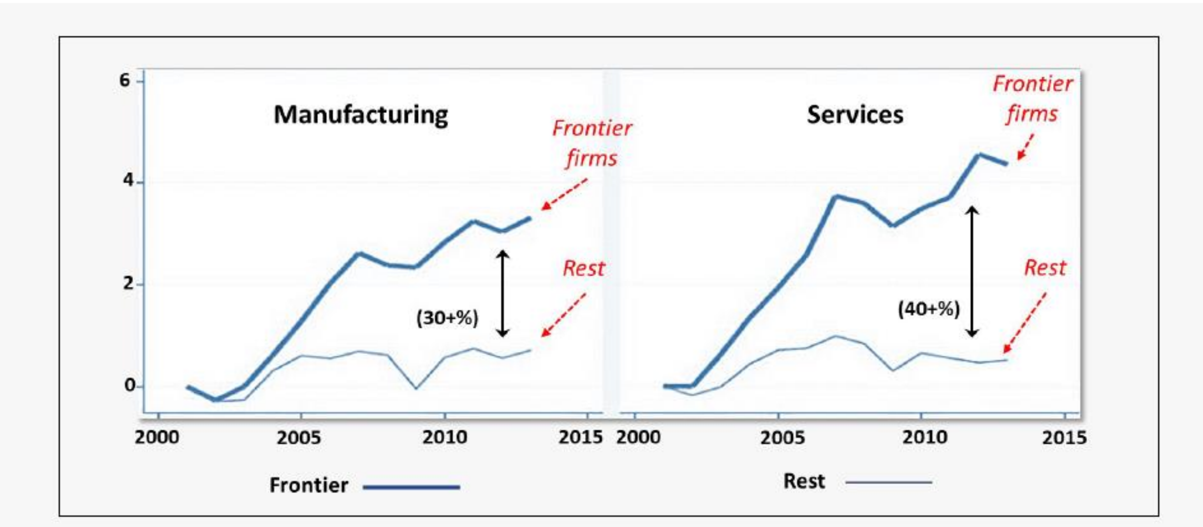
- In an 80% ideas based economy, productivity is generated by social interaction, where location matters. There is paradox of place – firms and the digital economy are situated in regions, and need density of place to grow.

- This needs a mixture of policies to bring it together. Policy therefore needs to focus on cities and their infrastructure and connectivity. This is particularly the case for a regional economy such as Northern Ireland.

SMEs

- Not only is there a productivity gap between nations, but there is one between frontier firms (i.e., large multinationals) and SMEs. See Figure 3, which shows a productivity gap opening up between the largest 5% of companies and the rest.
- Frontier firms are more integrated, invest more in R&D and attract the best talent.
- Many SMEs are ostriches, but they need to be magpies, copying and adopting the successful technology of frontier firms.
- Exports are beneficial for productivity, as it forces firms to compete.
- Organisations set up to help SMEs in the UK/NI were often passing fads, where organisations disappeared, and initiatives were short term. This has not been the case in Germany, for example, where there are specific institutions linked with universities and firms, which promote clustering, and help small firms with specialist knowledge.
- Germany and Northern Ireland share similarities in the extent of family firms, where there is social purpose, and they are embedded within communities. However, greater availability of finance in Germany, where there are smaller, regional banks, embedded in the local community, which are willing to go to the end of the world with their customers. In contrast, banks in the UK are centralised, and have moved away from this community model.

Figure 3: *The widening productivity gap between global frontier firms and the rest*



Source: OECD.

People

- Probably the most important factor in improving productivity is people – concentrated skills are needed, with a need for management training for those lower down firm's hierarchy. There is much more training in Germany, with a master in a trade, which combines technical experience with the skills needed to run a business. Workers move up through a company in Germany and receive much more training in leadership and management.
- The education sector has not kept pace with the skills required of today's economy.
- Northern Ireland's education system has contributed to the region's productivity problems: there is a long tail of underachievement, combined with brain drain.
- Social problems place a restriction on growth and tackling them forms an important part of any productivity strategy.

Further Reading

CBI, *Great Job: Solving the Productivity Problem through the Power of People*

Diane Coyle, *Rethinking Productivity*

Nick Crafts, *Is the UK Productivity Slowdown Unprecedented?*

Andrew Haldane, *The UK's Productivity Problem: Hub No Spokes*

OECD, *Global Forum on Productivity*